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CONSUMER CLASS ACTION

GOVERNMENT

MENTS

Storage

22 1971

HEARINGS

BEFORE THE

THE LIBRARY
KANSAS STATE UNIVERSITY

CONSUMER SUBCOMMITTEE

OF THE

COMMITTEE ON COMMERCE

UNITED STATES SENATE

NINETY-SECOND CONGRESS

FIRST SESSION

ON

S. 984

TO AUTHORIZE CLASSES OF PERSONS INJURED BY UNFAIR
CONSUMER PRACTICES UNLAWFUL UNDER THE FEDERAL
TRADE COMMISSION ACT TO SEEK RELIEF

S. 1222

TO PROVIDE INCREASED PROTECTION FOR CONSUMERS,
PREVENT CONSUMER FRAUD, AND FOR OTHER PURPOSES

S. 1378

TO PROVIDE IMPLEMENTATION OF THE FEDERAL TRADE
COMMISSION ACT, TO GIVE INCREASED PROTECTION TO
CONSUMERS, AND FOR OTHER PURPOSES

APRIL 27 AND 29, 1971

Serial No. 92-20

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CONSUMER CLASS ACTION

TUESDAY, APRIL 27, 1971

U.S. SENATE,
SENATE COMMITTEE ON COMMERCE,
CONSUMER SUBCOMMITTEE,
Washington, D.C.

The subcommittee was called to order at 9:40 a.m. in room 5110, New Senate Office Building, Hon. Frank E. Moss (chairman of the subcommittee) presiding.

Present: Senators Moss and Hatfield.

Senator Moss. The subcommittee will come to order.

We open hearings this morning on consumer class action bills and specifically on S. 984, S. 1222, and S. 1378.

OPENING STATEMENT BY THE CHAIRMAN

The subject of consumer class action was given extensive consideration last year. The Consumer Subcommittee held 8 days of hearings on it; the committee deliberated upon it over a spread of several months before reporting favorably an amended bill. The Judiciary Committee thereafter held 5 days of hearings on the amended bill.

S. 984 is nearly identical to the class action provisions of the bill reported by the committee last year. What differences there are result from separating from this pure class action bill the provisions of last year's bill strengthening the consumer protection powers of the Federal Trade Commission and the Department of Justice.

I will not take time now to summarize the provisions of the bills before us nor to recount the cases for and against them.

It is important to note, however, that even the most vigorous opponents to class action last year did not dispute the basic premise of the bill—that the deceived or defrauded consumer has no effective legal remedy. Despite his many rights in the law, the consumer is shut out of the courthouse by economic realities.

Neither was it disputed that consumers are cheated out of tremendous sums of money nor that they should have a remedy. Nonetheless, opponents of class action argue that the doors of the courthouse in the main should remain closed. Staunch defenders of the right to make a profit worry about profits for consumers' attorneys.

They argue that the legal system cannot bear the burden of handling consumer claims. Ever solicitous to ease the burdens of administering justice, they would summarily deny even the possibility of justice to consumers.

Staff members assigned to this hearing: John Cary.

Courts themselves, however, do not seem to share this fear of class action.

Last November 24 District Court Judge Gus Solomon wrote to Senator Magnuson:

Rule 23 of the Federal Rules of Civil Procedure gives ample authority to the trial judge to direct a flow of class actions efficiently and expeditiously and to police actual and incipient abuses of the class action mechanism. I have experienced no substantial difficulty in managing such cases.

Court of Appeals Judge David Bazelon wrote about the same time:

Experience demonstrates that class actions can be handled expeditiously, without unduly burdening the judicial system.

Neither judge believes that potential burden on the court should result in continued denial of access to the courts by consumers. Both supported the predecessor to S. 984.

Earlier this year, on April 5, the Supreme Court handed down a decision in *United Transportation Union v. The State Bar of Michigan*, which recognized the principle that "collective activity undertaken to obtain meaningful access to the courts is a fundamental right within the protection of the first amendment." It continued, "However, that right would be a hollow promise if courts could deny associations of workers and others the means of enabling their members to meet the costs of legal representation." In this case the court upheld a union practice of aiding its injured members in enforcing their rights under the Federal Employers' Liability Act. Pointing out that "the principle here involved cannot be limited to the facts of this case," the court set forth its strong support of new avenues of access to the court when traditional avenues prove ineffective or impractical and when representation of the right of individuals is blocked.

A clear parallel exists with consumer class action. Class action is group action and it provides a way to finance the bringing of small claims. Thus, the subcommittee is inclined to regard with skepticism arguments to the effect that the courts cannot handle, or indeed, fear, the advent of consumer class actions.

I am hopeful that, taking up where we left off last year, we may report a strong, effective measure in the interests of consumers.

(The bills and agency comments follow:)

92D CONGRESS
1ST SESSION

S. 984

IN THE SENATE OF THE UNITED STATES

FEBRUARY 25 (legislative day, FEBRUARY 17), 1971

Mr. MAGNUSON (for himself, Mr. MOSS, Mr. HART, Mr. BAYH, Mr. CRANSTON, Mr. EAGLETON, Mr. GRAVEL, Mr. HARRIS, Mr. HARTKE, Mr. HUGHES, Mr. HUMPHREY, Mr. INOUE, Mr. JACKSON, Mr. KENNEDY, Mr. MCGOVERN, Mr. MONDALE, Mr. MUSKIE, Mr. NELSON, Mr. RIBICOFF, and Mr. TUNNEY) introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To authorize classes of persons injured by unfair consumer practices unlawful under the Federal Trade Commission Act to seek relief.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Consumer Class Action
4 Act of 1971".

DEFINITIONS

6 SEC. 101. As used in this Act—

7 (1) "unfair consumer practice" means any of the
8 following acts or practices—

II

1 (A) offering goods or services intending not to
2 sell them as offered;

3 (B) advertising goods or services intending not
4 to supply reasonably expectable public demand, un-
5 less the advertisement discloses a limitation;

6 (C) knowingly making false or misleading
7 statements concerning the need for, or necessity of,
8 any goods, services, replacements, or repairs;

9 (D) representing that the consumer will obtain
10 any rights, privileges, or remedies knowing that the
11 consumer will not;

12 (E) representing that goods are new knowing
13 that they are not;

14 (F) representing that goods are of a particular
15 standard, grade, quality, style, or model knowing
16 they are not;

17 (G) knowingly making false or misleading
18 statements concerning (i) the reason for, existence
19 of, or amounts of price reductions, or (ii) savings
20 in comparison to prices of competitors or one's own
21 price;

22 (H) representing that goods or services are
23 those of another, knowing they are not;

24 (I) failing to return or refund deposits or ad-
25 vance payments for goods not delivered or services

1 not rendered, when no default or further obligation
2 of persons making such deposits or advance pay-
3 ments exists;

4 (J) knowingly representing that goods or serv-
5 ices have sponsorship, approval, origin, character-
6 istics of safety or performance, ingredients, uses,
7 benefits, or quantities that they do not have, or
8 that a person has a sponsorship, approval, status,
9 affiliation, or connection that he does not have, ex-
10 cept that the conduct described in this paragraph
11 (J) shall not be an unfair consumer practice if the
12 supplier shows that an affirmation merely of the
13 value of the goods or services, or a statement of
14 his opinion of the goods or services, or similar state-
15 ments, did not take unfair advantage of the level of
16 knowledge, ability, experience, or capacity of the
17 consumer;

18 (K) taking consideration for goods or services
19 intending not to deliver such goods or perform such
20 services, or intending to deliver goods or provide
21 services materially different from those ordered or
22 sold;

23 (L) knowingly making false or misleading
24 statements concerning the profitability, risk, or any

1 other material aspect of any home-operated business
2 opportunity or venture;

3 (M) offering gifts, prizes, free items, or other
4 gratuities, intending not to provide them as offered
5 in connection with a sale of goods or services to a
6 consumer;

7 (N) knowingly making false or misleading state-
8 ments concerning the existence, terms, or discount
9 offered as an inducement for the sale of goods or
10 services to a consumer in return for giving the sup-
11 plier the names of prospective consumers or other-
12 wise helping the offerer to enter into any other con-
13 sumer transaction;

14 (O) using physical force, threat of physical
15 force, undue harassment, or coercion in dealing with
16 consumers; and

17 (P) any other act or practice which is unfair
18 or deceptive to a consumer and is prohibited by sec-
19 tion 5 (a) (1) of the Federal Trade Commission Act
20 (15 U.S.C. 45 (a) (1)).

21 “(2) “knowing”, “knowingly”, and “knowledge”
22 mean actual knowledge, knowledge presumed where ob-
23 jective circumstances indicate that the supplier acted
24 with knowledge, or knowledge presumed where circum-
25 stances indicate that the supplier acted in disregard of

1 reasonable safeguards or care in ascertaining the truth
2 of representations made;

3 (3) "consumer" means any natural person who is
4 offered or supplied goods or services for personal, family,
5 or household purposes;

6 (4) "supplier" means any person who makes goods
7 or services available to consumers, either directly or
8 indirectly;

9 (5) "goods" includes real property, but does not
10 include securities, or interests in securities or aircraft to
11 the extent regulated in design or construction;

12 (6) "services" includes insurance services and
13 similar provisions of intangibles, but not the providing
14 of credit to the extent that credit is regulated under the
15 Truth in Lending Act (15 U.S.C. 1601, et seq.), or
16 the adequacy of service of common carriers to the extent
17 regulated; and

18 (7) "statement" means any representation in ad-
19 vertising, any oral or visual presentation, or any other
20 conduct intended to communicate to consumers.

21 SUITS BY CONSUMERS ADVERSELY AFFECTED

22 SEC. 102. (a) When a supplier in any proceeding
23 brought by the Federal Trade Commission under section 5,
24 of the Federal Trade Commission Act with respect to acts

1 or practices alleged to be unfair consumer practices within
2 the meaning of section 101 of this Act, has been ordered to
3 cease and desist from that act or practice, and the order
4 shall have become final within the meaning of section 5,
5 either after adjudication or by consent decree, any consumer
6 claiming to have been adversely affected by the act or
7 practice giving rise to such order may bring a civil action
8 against such supplier.

9 (b) (1) Notwithstanding subsection (a), a consumer
10 who has been injured by an unfair consumer practice may
11 sue as a representative party on behalf of all for redress of
12 such injury ninety days after the date on which the Federal
13 Trade Commission has been notified of such practice if such
14 action may be maintained as a class action under the Federal
15 Rules of Civil Procedure, except that no consumer shall be
16 a member of such class unless he shall have paid or become
17 obligated to pay an amount greater than \$10 in any transac-
18 tion as a result of such practice.

19 (2) Any action under this subsection may be brought
20 in the district courts of the United States and shall be gov-
21 erned by the Federal Rules of Civil Procedure.

22 (c) Actions pursuant to this section for redress of con-
23 sumer injury shall be administered, so far as practicable, to
24 facilitate voluntary settlements. The court shall have author-
25 ity in a representative action, upon the tender of a reason-

1 able settlement offer by the supplier to the entire class, to
2 supervise the submission of such settlement offer to the class.
3 The court may take reasonable steps to insure that the con-
4 sumers in the class are afforded the opportunity to exercise
5 an individual choice with respect to accepting or rejecting
6 any settlement offer. The court shall insure that equal space
7 for the presentation of views as to the merits of the offer
8 shall be tendered to members of the class and suppliers in
9 the notice of the offer to the members of the class. The cost
10 of communicating the offer, or subsequent offers, tendered
11 under the provisions of this section, to the members of the
12 class shall be borne by the defendants. Such settlement offer
13 shall be completed as expeditiously as possible.

14 (d) Whenever a consumer shall prevail in an action
15 brought pursuant to this section, he shall be allowed to re-
16 cover in addition to damages the costs of suit, including at-
17 torneys' fees. Such costs may be awarded from money dam-
18 ages which the defendant owes to members of the class who
19 cannot be located with due diligence. Upon termination of
20 a class action under this section, whether by judgment, set-
21 tlement or compromise, the court shall inquire into the rea-
22 sonableness of attorneys' fees charged and revise such fees
23 where necessary to assure a reasonable relationship, taking
24 into consideration the contingency of compensation, between
25 such fees and the actual time spent by attorneys in prepara-

tion and prosecution of the action. If the court determines that any class action brought pursuant to this section has been brought frivolously, with knowledge that the claim lacks probable cause and with intent to harass or intimidate the defendant, the court may in its discretion award the defendant the cost of defending the suit, including a reasonable attorney's fee.

(e) An action to enforce any claim under this section shall be forever barred unless commenced within three years after the claim arose.

FEDERAL TRADE COMMISSION ORDER AS EVIDENCE

SEC. 103. Any order entered by the Federal Trade Commission in any proceeding brought by the Commission under section 5 of the Federal Trade Commission Act enjoining any supplier from engaging in acts or practices declared to be an unfair consumer practice, having become final within the meaning of section 5, shall be prima facie evidence against that supplier in any action or proceeding brought by any other person against the supplier under section 206 of this title, as to all matters with respect to which such order would be an estoppel between the supplier and the Federal Trade Commission. This subsection shall apply only to orders based upon a preponderance of the evidence entered after an evidentiary hearing, and not to consent orders.

1 VENUE

2 SEC. 104. An action under this title may be brought in
 3 any district in which the claim arose or in which the defend-
 4 ant resides, is found, has an agent, is licensed to do business,
 5 or is doing business.

6 OTHER LAWS NOT AFFECTED

7 SEC. 105. This title shall not annul, alter, or affect in
 8 any manner the meaning, scope, or applicability of any
 9 Federal or State law, including but not limited to laws con-
 10 cerning the provision of goods and services to consumers, or
 11 limit in any way the availability of rights or remedies under
 12 Federal or State law.

92D CONGRESS
1ST SESSION

S. 1222

IN THE SENATE OF THE UNITED STATES

MARCH 12, 1971

Mr. MAGNUSON (by request) introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To provide increased protection for consumers, prevent consumer fraud, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Consumer Fraud Preven-
4 tion Act of 1971".

DEFINITIONS

6 SEC. 2. As used in this Act—

7 (a) "unfair consumer practice" means any of the
8 following acts or practices committed by a supplier—

9 (1) offering goods or services intending not to
10 sell them as offered for the purpose of inducing sales
11 of other or different goods or services;

1 (2) advertising goods or services intending not
2 to supply reasonably expectable public demand, un-
3 less the advertisement discloses a limitation;

4 (3) knowingly making false or misleading
5 statements concerning the need for, or necessity of,
6 any goods, services, replacements, or repairs;

7 (4) representing that the consumer will obtain
8 any rights, privileges, or remedies knowing that the
9 consumer will not;

10 (5) representing that goods are new knowing
11 that they are not;

12 (6) representing that goods are of a particular
13 standard, grade, quality, style, age, or model, know-
14 ing they are not, except that the conduct described
15 in this paragraph shall not be an unfair consumer
16 practice if the supplier shows that an affirmation
17 merely of the value of the goods or services, or a
18 statement of his opinion of the goods or services, or
19 similar statements, did not take unfair advantage
20 of the level of knowledge, ability, experience, or
21 capacity of the consumer;

22 (7) knowingly making false or misleading
23 statements concerning (i) the reason for, existence
24 of, duration of, or amounts of price reductions, or

1 (ii) savings in comparison to prices of competitors
2 or one's own price;

3 (8) representing that goods or services are
4 those of another, knowing they are not;

5 (9) failing to return or refund a deposit or
6 advance payments for goods not delivered or serv-
7 ices not rendered, when no default or further obli-
8 gation of the person making such deposit or advance
9 payment exists;

10 (10) knowingly representing that goods or
11 services have sponsorship, approval, origin, charac-
12 teristics of safety or performance, ingredients, uses,
13 benefits, or quantities that they do not have, or
14 that a person has a sponsorship, approval, status,
15 affiliation, or connection that he does not have,
16 except that the conduct described in this paragraph
17 shall not be an unfair consumer practice if the
18 supplier shows that an affirmation merely of the
19 value of the goods or services, or a statement of
20 his opinion of the goods or services, or similar
21 statements, did not take unfair advantage of the
22 level of knowledge, ability, experience, or capacity
23 of the consumer;

24 (11) taking consideration for goods or services

1 intending not to deliver such goods or perform such
2 services, or intending to deliver goods or provide
3 services which are materially different.

4 (12) offering gifts, prizes, free items, or other
5 gratuities, in connection with a sale of goods or
6 services to a consumer, intending not to provide
7 them as offered;

8 (13) knowingly making false or misleading
9 statements concerning the existence, terms, or
10 probability of any rebate, additional goods or serv-
11 ices, commission, or discount offered as an inducē-
12 ment for the sale of goods or services to a con-
13 sumer in return for giving the supplier the names
14 of prospective consumers or otherwise helping the
15 supplier to enter into any other consumer trans-
16 action;

17 (14) using physical force, threat of physical
18 force, or undue harassment in dealing with a
19 consumer;

20 (b) "knowing", "knowingly", and "knowledge"
21 refer to actual knowledge, knowledge presumed where
22 objective circumstances indicate that the supplier acted
23 with knowledge, or knowledge presumed where cir-
24 cumstances indicate that the supplier acted in disregard

1 of reasonable safeguards or care in ascertaining the
2 truth of representations made;

3 (c) "consumer" means any natural person who is
4 offered or supplied goods or services for personal, fam-
5 ily, or household purposes;

6 (d) "supplier" means any person in the business
7 of making goods or services available to consumers,
8 either directly or indirectly;

9 (e) "goods" means tangible personal property but
10 does not include securities, or interests in securities, or
11 aircraft to the extent regulated in design and construc-
12 tion; "goods" includes personal property intended to be
13 attached to or installed in any real property without
14 regard to whether it is so attached or installed;

15 (f) "services" includes the provision of intangibles,
16 other than—

17 (i) insurance services;

18 (ii) credit services and services by common
19 carriers and public utilities, to the extent that un-
20 fair consumer practices are prohibited with respect
21 to these services under other Federal law regu-
22 lations; and

23 (g) "statement" means any representation in ad-
24 vertising, any oral or visual presentation, or any other
25 conduct intended to communicate to consumers.

1 UNFAIR CONSUMER PRACTICES UNLAWFUL

2 SEC. 3. (a) It is unlawful for any supplier to commit
3 any unfair consumer practice.

4 (b) An unfair consumer practice under this Act is an
5 unfair or deceptive practice under section 5 of the Federal
6 Trade Commission Act.

7 CIVIL PENALTIES

8 SEC. 4. A supplier who willfully commits an unfair con-
9 sumer practice shall be subject to a civil penalty of not
10 more than \$10,000 for each such act. The civil penalty may
11 be assessed in an action instituted by the Attorney Gen-
12 eral under section 5 of this Act.

13 RESTRAINING VIOLATIONS

14 SEC. 5. The United States district courts, the District
15 Court of Guam, and the District Court of the Virgin Islands
16 shall have jurisdiction to restrain violations of this Act in
17 actions brought by the Attorney General. The court may at
18 any time grant such injunctive relief as it deems appropriate.
19 Whenever it appears to the court that the ends of justice
20 require that other persons should be parties in the action, the
21 court may cause them to be summoned whether or not they
22 reside in the district in which the court is held, and to that
23 end process may be served in any district.

1 SUITS BY CONSUMERS ADVERSELY AFFECTED

2 SEC. 6. (a) When a supplier (i) in an action brought
3 by the Attorney General under section 5 of this Act, has
4 been enjoined from committing any unfair consumer practice,
5 whether after final adjudication or by consent decree, or (ii)
6 in a proceeding brought by the Federal Trade Commission
7 under section 5 of the Federal Trade Commission Act with
8 respect to acts or practices alleged to be unfair consumer
9 practices within the meaning of section 2 of this Act, has
10 been ordered to cease and desist from such unfair consumer
11 practice, and the order has become final within the meaning
12 of section 5, either after adjudication or by consent decree—
13 any consumer claiming to have been adversely affected by
14 the act or practice may bring suit against the supplier in a
15 United States district court, the District Court of Guam, or
16 the District Court of the Virgin Islands, and may recover
17 actual damages, and the costs of suit, including reasonable
18 attorneys' fees, and, when appropriate, restitution, reforma-
19 tion, rescission, and other equitable relief.

20 (b) Irrespective of whether an attorney's fee is assessed
21 against the supplier, the court may inquire into the reason-

1 ableness of the fee agreed upon between the consumer and
2 his counsel, and revise that fee as the circumstances warrant.

3 (c) In any action brought under this section, a sup-
4 plier may, before trial or within thirty days after a judgment
5 of liability in the case of a separate trial on the issues of
6 liability and relief, submit to the district court a plan for
7 relief for consumers injured by the unfair consumer practice
8 and on whose behalf the action is properly maintained. Such
9 a plan may be approved by the district court if the court
10 finds that such plan will reasonably assure that—

11 (1) it will be administered in a fair and impartial
12 manner and adequate funds will be made available to
13 pay for the costs and expenses of maintaining and ad-
14 ministering the plan;

15 (2) reasonable notice will be provided to consum-
16 ers who may have been damaged by unfair consumer
17 practices;

18 (3) aggrieved consumers will be afforded an op-
19 portunity to apply for relief within a reasonable time,
20 not in excess of one year from the date of approval of
21 the plan; and

22 (4) adequate funds will be available, or other ade-
23 quate arrangements will be made, for relief through the
24 plan, and for this purpose a bond may be required.

25 Promptly upon the filing of a plan the supplier shall cause

9

1 to be issued public notice as approved by the court advising
2 of the submission of the plan. Within twenty days from
3 the publication of such notice persons who may be finan-
4 cially interested in the proceeding may submit written com-
5 ments on the adequacy of the plan to the court. Any party
6 to the action may request a hearing on the adequacy of
7 the plan. Upon approval, such plan shall be entered as part
8 of a final judgment and decree and the court shall retain
9 jurisdiction to the extent necessary to supervise its opera-
10 tion. In the course of supervising the plan, the court may
11 hold hearings and issue orders and opinions.

12 JUDGMENT IN FAVOR OF THE UNITED STATES AS EVIDENCE

13 SEC. 7. A final judgment or decree rendered in any
14 proceeding brought by the United States under section 5
15 of this Act to the effect that a supplier has engaged in an
16 unfair consumer practice within the meaning of this Act
17 shall be prima facie evidence against that supplier in any
18 action or proceeding brought by any consumer against the
19 supplier under section 6 of this Act, as to all matters respect-
20 ing which said judgment or decree would be an estoppel as
21 between the supplier and the United States: *Provided,*
22 *however,* That this subsection shall not apply to consent
23 judgments or decrees entered before any testimony has
24 been taken.

1 VENUE

2 SEC. 8. An action under this Act may be brought in
3 any district in which the claim arose or in which the sup-
4 plier resides, is found, has an agent, is licensed to do busi-
5 ness, or is doing business.

6 LIMITATIONS OF ACTIONS

7 SEC. 9. Any action under section 6 of this Act shall
8 be brought within one year after the termination of the
9 proceeding under section 5 of this Act or under section 5
10 of the Federal Trade Commission Act on which it is
11 predicated.

12 CIVIL INVESTIGATIVE DEMANDS

13 SEC. 10. (a) Whenever the Attorney General has
14 reason to believe that any person under investigation for
15 any violation of the provisions of this Act may be in pos-
16 session, custody, or control of any documentary material,
17 or may have knowledge of any fact, relevant to an unfair
18 consumer practice within the meaning of this Act, he may,
19 prior to the institution of a civil proceeding under section 5,
20 issue in writing, and cause to be served upon such person,
21 a civil investigative demand, requiring such person to pro-
22 duce the documentary material for examination or to an-
23 swer in writing written interrogatories pertaining to such
24 knowledge.

25 (b) Each such demand shall—

1 (1) state the nature of the conduct alleged to con-
2 stitute the unfair consumer practice which is under
3 investigation;

4 (2) describe the class or classes of documentary
5 material to be produced thereunder with such definite-
6 ness and certainty as to permit such material to be
7 fairly identified;

8 (3) propound with definiteness and certainty the
9 written interrogatories to be answered;

10 (4) prescribe a return date which will provide a
11 reasonable period of time within which the material
12 so demanded may be assembled and made available for
13 inspection and copying or reproduction or within which
14 the interrogatories propounded may be answered; and

15 (5) identify the custodian to whom such material
16 shall be furnished, or the person to whom such answers
17 shall be made.

18 (c) No demand shall—

19 (1) contain any requirement which would be un-
20 reasonable if contained in a subpoena duces tecum
21 issued by a court of the United States in a proceeding
22 brought under section 5 of this Act or if propounded in
23 an interrogatory directed to a supplier in any such pro-
24 ceedings; or

25 (2) require the production of any documentary

1 evidence, or the disclosure of any information, which
2 would be privileged from disclosure if demanded by a
3 subpoena duces tecum issued by a court of the United
4 States, or by an interrogatory propounded, in any pro-
5 ceeding under section 5 of this Act.

6 (d) Demand may be served at any place within the
7 territorial jurisdiction of any court of the United States.

8 (e) Service of any such demand or of any petition
9 filed under subsection (f) of this section may be made upon
10 a partnership, corporation, association, or other legal entity
11 by—

12 (1) delivering a duly executed copy thereof to any
13 partner, executive officer, managing agent, or general
14 agent thereof, or to any agent thereof authorized by
15 appointment or by law to receive service of process on
16 behalf of such partnership, corporation, association, or
17 entity;

18 (2) delivering a duly executed copy thereof to the
19 principal office or place of business of the partnership,
20 corporation, association, or entity to be served; or

21 (3) depositing such copy in the United States
22 mails, by registered or certified mail duly addressed to
23 such partnership, corporation, association, or entity at its
24 principal office or place of business.

25 (f) A verified return by the individual serving any

1 such demand or petition setting forth the manner of such
2 service shall be proof of such service. In the case of service
3 by registered or certified mail, such return shall be accom-
4 panied by the return post office receipt of delivery of such
5 demand.

6 (g) The provisions of sections 4 and 5 of the Antitrust
7 Civil Process Act (15 U.S.C. 1313, 1314) shall apply to
8 custodians of material produced pursuant to any demand and
9 to judicial proceedings for the enforcement of any such de-
10 mand made pursuant to this section: *Provided, however,*
11 That documents and other information obtained pursuant to
12 any civil investigative demand issued hereunder and in the
13 possession of the Department of Justice may be made avail-
14 able to duly authorized representatives of the Federal Trade
15 Commission for the purpose of investigations and proceed-
16 ings under the Federal Trade Commission Act.

17 REPORTS OF THE ATTORNEY GENERAL

18 SEC. 11. The Attorney General shall annually report
19 to the President and to the Congress on the effectiveness of
20 this Act.

21 OTHER LAWS NOT AFFECTED

22 SEC. 12. This Act shall not annul, alter, or affect in any
23 manner the meaning, scope, or applicability of any Federal
24 or State law, including but not limited to laws concerning

1 the provision of goods and services to consumers and the
2 Public Health Cigarette Smoking Act of 1969.

3 SEPARABILITY

4 SEC. 13. If any provision of this Act is declared uncon-
5 stitutional, or the applicability thereof to any person or
6 circumstance is held invalid, the constitutionality of the
7 remainder of the Act and the applicability thereof to other
8 persons and circumstances shall not be affected thereby.

92^D CONGRESS
1ST SESSION

S. 1378

IN THE SENATE OF THE UNITED STATES

MARCH 24 (legislative day, MARCH 23), 1971

Mr. BAYH introduced the following bill; which was read twice and referred to the Committee on Commerce

A BILL

To provide implementation of the Federal Trade Commission Act, to give increased protection to consumers, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Consumer Class Action
4 Act of 1971".

5 SEC. 2. FINDINGS AND PURPOSE.—The Congress finds
6 that there is a Federal interest in curbing unfair and deceptive
7 practices which affect commerce. Congress finds that it pro-
8 motes the free flow of goods in commerce and promotes the
9 public welfare to provide an adequate process for class actions
10 on behalf of similarly situated consumers.

11 SEC. 3. DEFINITIONS.—As used in this title—

1 (a) "Unfair consumer practice" means any of the
2 following:

3 (1) any material statement, whether oral, written,
4 or by visual description or other representation of any
5 kind, or by half-truth or intentional omission, in connec-
6 tion with the sale, lease, rental or loan or the offering for
7 sale, lease, rental, or loan of goods or services to con-
8 sumers, or the extension of credit to consumers, or the
9 collection of debts from consumers, which has the capac-
10 ity, tendency or effect of misleading or deceiving con-
11 sumers. Such statements include, but are not limited to—

12 (A) offering goods or services intending not to
13 sell them as offered;

14 (B) advertising goods or services intending not
15 to supply reasonably expectable public demand, un-
16 less the advertisement accurately discloses the
17 limitation;

18 (C) making misleading statements concerning
19 the need for any goods, services, or repairs;

20 (D) making misleading statements concerning
21 the rights, obligations, liabilities, privileges or reme-
22 dies of the consumer;

23 (E) representing that goods are new when
24 they are not;

25 (F) representing that goods are of a particular

1 standard, grade, quality, style, or model when they
2 are not;

3 (G) making misleading statements concerning
4 the reasons for, existence of, or amounts of price
5 reductions or comparative price or value;

6 (H) representing that goods or services are
7 those of another, when they are not;

8 (I) representing that goods or services have
9 sponsorship, approval, origin, characteristics of
10 safety, performance or non-pollution, ingredients,
11 uses, benefits, or quantities that they do not have, or
12 that a person has a sponsorship, approval, status,
13 affiliation or connection that he does not have;

14 (J) taking consideration for goods or services
15 without delivering the goods, performing the serv-
16 ices or refunding the consideration within a reason-
17 able period of time;

18 (K) making misleading statements concerning
19 the profitability, risk, or any other material respect
20 of any business opportunity or venture, or prepara-
21 tion or course of study for same, intended to be
22 embarked upon by a natural person;

23 (L) offering gifts, prizes, free items or other
24 gratuities without providing them as offered;

25 (M) making misleading statements concerning

1 the existence, terms or probability of any rebate, ad-
2 ditional goods or services, commission or discount
3 offered as an inducement for the sale of goods or
4 services to a consumer in return for giving the sup-
5 plier the names of prospective consumers or other-
6 wise helping the offerer to enter into any other
7 consumer transaction;

8 (N) threatening that a creditor will take action
9 that he does not actually take in the regular course
10 of business;

11 (2) the use or threat of physical force against con-
12 sumers or the undue harassment or coercion of consumers;

13 (3) failure to return deposits or advance payments
14 for goods not delivered or services not rendered, when
15 no default or further obligation of persons making such
16 deposits or advance payments exists;

17 (4) violations which give rise to civil liability under
18 state statutory or decisional law for the benefit of
19 consumers;

20 (5) any other action prohibited by rule of the Fed-
21 eral Trade Commission, in accordance with the provisions
22 of section 6(g) of the Federal Trade Commission Act
23 (15 USC 46(g)), as amended, provided that such
24 rule—

1 (A) became effective prior to the time of the
2 action complained of, and

3 (B) was expressly designated by the Federal
4 Trade Commission as a rule intended to constitute
5 the basis of civil liability under this Act.

6 (b) "Intentional", and "intending" refer to actual in-
7 tent, intent presumed where objective circumstances indicate
8 that the person acted with intent, or intent presumed where
9 circumstances indicate that the supplier acted in disregard
10 of reasonable safeguards or care;

11 (c) "Consumer" means any natural person who is of-
12 fered or supplied goods or services for personal, family, or
13 household purposes, or who is offered a personal business or
14 money-making opportunity;

15 (d) "Goods" includes real property but does not include
16 securities or interests in securities or aircraft to the extent
17 regulated in design or construction;

18 (e) "Services" includes insurance services.

19 SEC. 4. It shall be unlawful for a person to commit any
20 unfair consumer practice as defined in this Act if—

21 (a) his business affects commerce; or

22 (b) the violation or violations affect commerce.

23 SEC. 5. The district courts of the United States shall
24 have original jurisdiction of civil class actions brought by a
25 consumer or group of consumers under this act on behalf of

1 himself or themselves and all consumers similarly situated.
2 The jurisdiction of district courts of the United States under
3 this section shall be concurrent with that of the courts of
4 the several States. If an action under this Act is brought
5 in a court of a State, the provisions of rule 23 of the Federal
6 Rules of Civil Procedure shall apply to such action to the
7 same extent that such provisions apply in the case of an
8 action brought in a United States District Court.

9 SEC. 6. (a) In order for an action to be entertained
10 under this Act, the court must find that the action is of such
11 nature as to be entertainable under rule 23 of the Federal
12 Rules of Civil Procedure.

13 (b) If the court finds that the case is entertainable
14 under rule 23 of the Federal Rules of Civil Procedure, it may
15 nevertheless decide, in its discretion, whether or not the con-
16 troversy should be entertained or dismissed without prejudice
17 to refiling the same in a court of competent jurisdiction of the
18 State. In so determining the court shall consider—

- 19 (1) the nature and importance of the case;
20 (2) the condition of its docket and the likelihood
21 that the matter would unduly delay other cases;
22 (3) the multidistrict or multistate nature of the
23 matter; and
24 (4) the relative procedural advantages of trying the
25 case in the Federal or in the State court.

7

1 (c) In order for an action to be entertained under this
2 Act in a district court of the United States the court shall
3 make a determination of whether or not the amount which
4 can reasonably be expected to be the amount in controversy
5 exceeds \$25,000. If such amount cannot reasonably be
6 expected to exceed \$25,000, then the court shall not enter-
7 tain the action. For the purposes of this paragraph, the ag-
8 gregate claims for all members of the class shall be taken into
9 account to make up such requisite amount, and, if injunctive
10 relief is sought and may reasonably be expected to be appro-
11 priate, the court shall consider the probable damages to the
12 class if injunctive relief were not granted as an item in mak-
13 ing up such requisite amount.

14 SEC. 7. No person shall be a member of a class in an
15 action under this Act unless the amount of his loss or claim
16 exceeds ten dollars.

17 SEC. 8. In any action under this Act, the court shall
18 only award—

- 19 (a) injunctive and declaratory relief;
- 20 (b) restitution and actual damages;
- 21 (c) relief or penalties specifically provided for under
22 any statute giving rise to a right within the jurisdiction
23 of the court in a case arising under this Act; and
24 (d) costs of court as provided in section 14; and

1 in no event shall award damages for personal injury or
2 exemplary damages.

3 SEC. 9. In an action in a United States District Court
4 under this Act based upon violations of State law, the law of
5 the States shall be applied as if jurisdiction were based upon
6 diversity of citizenship.

7 SEC. 10. Section 1441 of title 28, United States Code,
8 shall not apply with respect to any action of which the dis-
9 trict courts have jurisdiction solely by reason of the fact that
10 the act complained of is alleged to be a violation of State
11 statutory or decisional law for the benefit of consumers.

12 SEC. 11. At least thirty-five days prior to instituting an
13 action under this Act, the prospective plaintiff or plaintiffs
14 shall mail notice to the prospective defendant or defendants
15 informing them, in general terms, of the nature of the alleged
16 unfair consumer practice or practices. No action for mone-
17 tary relief may be maintained if, within thirty days after
18 the mailing of the notice, the prospective defendant or
19 defendants—

20 (a) identify from business records all consumers
21 similarly situated and notify them that appropriate re-
22 funds, credits, adjustments, replacements, or repairs will
23 be made within thirty additional days; provided that
24 where sales, leases, rentals or loans were effected through
25 misleading statements, the defendants must notify the

1 affected consumers that their money will be refunded
2 upon their tender of the merchandise or any unused por-
3 tion of the services, and where consumer debts were col-
4 lected through misleading statements, the defendants
5 must notify the affected consumers that the money will
6 be refunded upon request; and

7 (b) cease the alleged unfair consumer practice or
8 practices. Evidence of compliance or attempted com-
9 pliance with this section shall not be construed as an
10 admission of engaging in an unlawful practice.

11 SEC. 12. Actions pursuant to this Act shall be admin-
12 istered, so far as feasible within the discretion of the court,
13 to avoid a multiplicity of suits, to avoid duplicating or over-
14 lapping class actions, and to avoid expenses of litigation which
15 unduly repress obtaining justice under the Act. Such admin-
16 istration shall include, but shall not be limited to, assessing
17 the costs of any required notice of the action as justice
18 requires and providing for the use of facilities of the court,
19 including mailing privileges, in such manner as justice
20 requires.

21 SEC. 13. Actions pursuant to this section for redress of
22 consumer injury shall be administered, so far as practicable,
23 to facilitate voluntary settlements. The court shall have au-
24 thority, upon the tender of a reasonable settlement offer by
25 the defendant or defendants to the entire class, to supervise

1 the submission of such settlement offer to the class. The court
2 may take reasonable steps to insure that the consumers in the
3 class are afforded, so far as feasible as determined by the
4 court, the opportunity to exercise an individual choice with
5 respect to accepting or rejecting any settlement offer. The
6 court shall insure that equal space for the presentation of
7 views as to the merits of the offer shall be tendered to plain-
8 tiffs and defendants in the notice of the offer to the members
9 of the class. The cost of communicating the offer, or subse-
10 quent offers, tendered under the provisions of this section to
11 the members of the class, shall be borne by the defendants.
12 Such settlement offers shall be completed as expeditiously as
13 possible.

14 SEC. 14. Whenever a consumer shall prevail in an action
15 brought pursuant to this section, he shall be allowed to re-
16 cover, in addition to damages, the costs of suit, including
17 attorneys' fees. Such costs may be awarded from money
18 damages which the defendant owes to members of the class
19 who cannot be located with due diligence. Upon termination
20 of a class action under this Act, whether by judgment, settle-
21 ment or compromise, the court shall inquire into the reason-
22 ableness of attorneys' fees charged and revise such fees where
23 necessary to assure that they are reasonable, taking into con-
24 sideration, among other factors, the contingency of success,
25 the actual time spent by attorneys in preparation and prose-

1 eution of the action, the difficulty of the case, the experience
2 of plaintiffs' counsel, the amount recovered in the action, and
3 the benefits to the public of the litigation.

4 SEC. 15. An action to enforce any claim under this sec-
5 tion shall be forever barred unless commenced within three
6 years after the claim arose, except that in the case of an
7 action dismissed without prejudice to be filed in a State court
8 under section 9 this limitation shall be tolled between the
9 time that the action is commenced in Federal court and one
10 month after the Federal court dismisses the action without
11 prejudice to refiling.

12 SEC. 16. An action under this title may be brought in
13 any district in which the claim arose or in which the defend-
14 ant resides, is found, has an agent, is licensed to do business,
15 or is doing business.

16 SEC. 17. This Act shall not annul, alter, or affect in any
17 manner the meaning, scope, or applicability of any Federal
18 or State law except as specifically provided herein (as, for
19 instance, in the case of application of Federal Rule 23 in
20 cases brought upon a claim under this Act in State court),
21 including but not limited to laws concerning the provision of
22 goods and services to consumers and Public Law 91-222 (84
23 Stat. 87), or limit in any way the availability of rights or
24 remedies under such law.

- 1 SEC. 18. If any provision of this Act is declared uncon-
2 stitutional, or the applicability thereof to any person or
3 circumstance is held invalid, the constitutionality of the
4 remainder of the Act and the applicability thereof to other
5 persons and circumstances shall not be affected thereby.

OFFICE OF THE DEPUTY ATTORNEY GENERAL,
Washington, D.C., 20530, April 1, 1971.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate,
Washington, D.C., 20510

DEAR SENATOR: This is in response to your requests for the views of the Department of Justice on S. 1219, S. 1221, and S. 1222, bills relating to increased protection for consumers.

This legislation was sent to the Congress by the Attorney General in pursuance of President Nixon's consumer message of February 24, 1971. The purposes of the proposals are explained in the Attorney General's letters of March 8, 1971 to the Vice President, copies of which are enclosed.

As you know, Mr. Chairman, the Subcommittee on Consumers has conducted hearings on S. 986, dealing with consumer product warranties and improvements to the Federal Trade Commission Act, and has graciously added S. 1219 and S. 1221, dealing with those subjects, as subjects of the hearings. Assistant Attorney General McLaren expressed the Department's views on all three bills when he testified before the Subcommittee on March 22, 1971. A copy of his statement is enclosed.

The Department of Justice recommends enactment of this legislation.

The Office of Management and Budget has advised that there is no objection to the submission of this report, and that enactment of the legislation is in accord with the program of the President.

Sincerely,

RICHARD G. KLEINDIENST,
Deputy Attorney General.

OFFICE OF THE ATTORNEY GENERAL,
Washington, D.C., 20530 March 8, 1971.

The VICE PRESIDENT,
U.S. Senate,
Washington, D.C.

Dear MR. VICE PRESIDENT: There is enclosed for your consideration and appropriate reference a legislative proposal entitled the "Consumer Fraud Prevention Act of 1971."

This proposed legislation carries out in part the February 24 Consumer Message of the President. As more fully described in the accompanying explanatory statement, the proposed Act is designed to improve the legal machinery for consumer protection and to improve the ability of persons injured by unfair consumer practices to secure appropriate relief.

The Act explicitly sets forth the types of unfair consumer practices declared to be unlawful and would, for the first time, clearly define the rights of consumers and the respective obligations of suppliers. The proposed legislation would enable consumers who have been injured by unfair consumer practices to recover damages and other relief after the successful termination of a government proceeding.

The enactment of this legislation will constitute a significant step in protecting American consumers from fraud and deception.

The Office of Management and Budget has advised that submission of this legislation is in accord with the program of the President.

Sincerely,

JOHN N. MITCHELL,
Attorney General.

EXPLANATORY STATEMENT TO ACCOMPANY THE PROPOSED CONSUMER FRAUD
PREVENTION ACT OF 1971

Section 2. Defines the types of unfair consumer practices which are prohibited. The commission of any such practice would subject a supplier to suits by the Attorney General for injunctive relief and civil penalties and to suits by aggrieved consumers for damages, restitution or other appropriate relief. This list of practices is similar to those recommended in the Federal Trade Commission's proposals for state legislation dealing with unfair and deceptive prac-

tices and includes certain practices which would have been prohibited under S. 3201, as reported by the Committee on Commerce during the 91st Congress. The definitions of unfair consumer practices are drawn so as to give suppliers clear notice of the acts and practices which are prohibited.

Section 3. Declares unlawful the unfair consumer practices defined in Section 2. In addition, this section also provides that the commission of any such unfair consumer practice shall also constitute a violation of Section 5 of the Federal Trade Commission Act, thus making clear that the FTC has enforcement responsibilities under the Act.

Section 4. Provides that civil penalties of up to \$10,000 may be assessed for each offense against suppliers who commit unfair consumer practices.

Section 5. Confers jurisdiction on the United States district courts to entertain actions brought by the Attorney General to restrain the commission of unfair consumer practices and to assess civil penalties. The courts are further empowered to assure that all persons responsible for an alleged violation may be brought before them and be subject to their jurisdiction.

Section 6. Following successful termination of litigation instituted by the Attorney General or proceedings before the Federal Trade Commission, consumers would be enabled to bring suit for private recovery. The section authorizes all forms of relief appropriate to the circumstances, including reformation, restitution, and rescission and the court may award costs, including reasonable attorneys' fees. In such litigation the courts may also inquire into the reasonableness of attorneys' fees agreed to by consumer plaintiffs and revise such fees if found to be excessive. In federal courts, consumers may sue as a class when a group has been damaged by the same act or practice. This opportunity to participate in a class action should be of considerable benefit to consumers. The costs and other burdens of litigation are often too much for individual consumers to bear; but if consumers can sue as a group, the burdens of litigation will not weigh too heavily on any one member of the group.

This section further provides that a supplier being sued hereunder may submit to the Federal district court a plan for the relief of injured consumers. The district court is to pass upon the fairness and adequacy of the plan. These provisions are designed to provide prompt and effective relief with a minimum of judicial oversight in appropriate cases.

Section 7. Borrowed in substance from existing antitrust laws, this section provides that after the United States has obtained a judgment or decree under Section 5, consumers in private litigation need not prove that the unfair consumer practice was in fact committed by the same supplier. This *prima facie* case does not occur, however, if the supplier entered in to a consent judgment or decree before the taking of any testimony in the action by the United States.

Section 8. Affords consumers the widest possible choice of courts in which to bring their suits. A suit may be brought in any district in which the unfair consumer practice is alleged to have occurred or where the supplier resides, is found, has an agent, is licensed to do business, or is doing business.

Section 9. Provides that private actions in the federal courts under Section 6 of this Act must be brought with one year after the termination of the suit by the Attorney General or the Federal Trade Commission proceeding on which they are predicated.

Section 10. Gives to the Attorney General an investigative tool similar to that provided in the Antitrust Civil Process Act. Provides that the Attorney General may demand certain information and documentary evidence from persons under investigation for possible violations of the Act.

Section 11. Requires the Attorney General to report annually to the President and the Congress on the effectiveness of the legislation.

Section 12. Contains a Congressional direction that this legislation is not intended to affect in any way other state or federal consumer laws, rights or remedies.

Section 13. Provides that if any portion of this legislation is declared unconstitutional the remainder shall not be affected.

A BILL To provide increased protection for consumers, prevent consumer fraud, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Consumer Fraud Prevention Act of 1971".

DEFINITIONS

SEC. 2. As used in this Act—

(a) "unfair consumer practice" means any of the following acts or practices committed by a supplier—

(1) offering goods or services intending not to sell them as offered for the purpose of inducing sales of other or different goods or services;

(2) advertising goods or services intending not to supply reasonably expectable public demand, unless the advertisement discloses a limitation;

(3) knowingly making false or misleading statements concerning the need for, or necessity of, any goods, services, replacements, or repairs;

(4) representing that the consumer will obtain any rights, privileges, or remedies knowing that the consumer will not;

(5) representing that goods are new knowing that they are not;

(6) representing that goods are of a particular standard, grade, quality, style, age, or model, knowing they are not, except that the conduct described in this paragraph shall not be an unfair consumer practice if the supplier shows that an affirmation merely of the value of the goods or services, or a statement of his opinion of the goods or services, or similar statements, did not take unfair advantage of the level of knowledge, ability, experience, or capacity of the consumer;

(7) knowingly making false or misleading statements concerning (i) the reason for, existence of, duration of, or amounts of price reductions, or (ii) savings in comparison to prices of competitors or one's own price;

(8) representing that goods or services are those of another, knowing they are not;

(9) failing to return or refund a deposit or advance payments for goods not delivered or services not rendered, when no default or further obligation of the person making such deposit or advance payment exists;

(10) knowingly representing that goods or services have sponsorship, approval, origin, characteristics of safety or performance, ingredients, uses, benefits, or quantities that they do not have, or that a person has a sponsorship, approval, status, affiliation, or connection that he does not have, except that the conduct described in this paragraph shall not be an unfair consumer practice if the supplier shows that an affirmation merely of the value of the goods or services, or a statement of his opinion of the goods or services, or similar statements, did not take unfair advantage of the level of knowledge, ability, experience, or capacity of the consumer;

(11) taking consideration for goods or service intending not to deliver such goods or perform such services, or intending to deliver goods or provide services which are materially different.

(12) offering gifts, prizes, free items, or other gratuities, in connection with a sale of goods or services to a consumer, intending not to provide them as offered;

(13) knowingly making false or misleading statements concerning the existence, terms, or probability of any rebate, additional goods or services, commission, or discount offered as an inducement for the sale of goods or services to a consumer in return for giving the supplier the names of prospective consumers or otherwise helping the supplier to enter into any other consumer transaction;

(14) using physical force, threat of physical force, or undue harassment in dealing with a consumer;

(b) "knowing", "knowingly", and "knowledge" refer to actual knowledge, knowledge presumed where objective circumstances indicate that the supplier acted with knowledge, or knowledge presumed where circumstances indicate that the supplier acted in disregard of reasonable safeguards or care in ascertaining the truth of representations made;

(c) "consumer" means any natural person who is offered or supplied goods or services for personal, family, or household purposes;

(d) "supplier" means any person in the business of making goods or services available to consumers, either directly or indirectly;

(e) "goods" means tangible personal property but does not include securities, or interests in securities, or aircraft to the extent regulated in design and construction; "goods" includes personal property intended to be attached to or

installed in any real property without regard to whether it is so attached or installed;

- (f) "services" includes the provision of intangibles, other than—
 - (i) insurance services
 - (ii) credit services and services by common carriers and public utilities, to the extent that unfair consumer practices are prohibited with respect to these services under other Federal law or regulations; and
- (g) "statement" means any representation in advertising, any oral or visual presentation, or any other conduct intended to communicate to consumers.

UNFAIR CONSUMER PRACTICES UNLAWFUL

SEC. 3. (a) It is unlawful for any supplier to commit any unfair consumer practice.

(b) An unfair consumer practice under this Act is an unfair or deceptive practice under section 5 of the Federal Trade Commission Act.

CIVIL PENALTIES

SEC. 4. A supplier who willfully commits an unfair consumer practice shall be subject to a civil penalty of not more than \$10,000 for each such act. The civil penalty may be assessed in an action instituted by the Attorney General under section 5 of this Act.

RESTRAINING VIOLATIONS

SEC. 5. The United States district courts, the District Court of Guam, and the District Court of the Virgin Islands shall have jurisdiction to restrain violations of this Act in actions brought by the Attorney General. The court may at any time grant such injunctive relief as it deems appropriate. Whenever it appears to the court that the ends of justice require that other persons should be parties in the action, the court may cause them to be summoned whether or not they reside in the district in which the court is held, and to that end process may be served in any district.

SUITS BY CONSUMERS ADVERSELY AFFECTED

SEC. 6. (a) When a supplier—(i) in an action brought by the Attorney General under section 5 of this Act, has been enjoined from committing any unfair consumer practice, whether after final adjudication or by consent decree, or (ii) in a proceeding brought by the Federal Trade Commission under section 5 of the Federal Trade Commission Act with respect to acts or practices alleged to be unfair consumer practices within the meaning of section 2 of this Act, has been ordered to cease and desist from such unfair consumer practice, and the order has become final within the meaning of section 5, either after adjudication or by consent decree—any consumer claiming to have been adversely affected by the act or practice may bring suit against the supplier in a United States district court, the District Court of Guam, or the District Court of the Virgin Islands, and may recover actual damages, and the costs of suit, including reasonable attorneys' fees, and, when appropriate, restitution, reformation, rescission, and other equitable relief.

(b) Irrespective of whether an attorney's fee is assessed against the supplier, the court may inquire into the reasonableness of the fee agreed upon between the consumer and his counsel, and revise that fee as the circumstances warrant.

(c) In any action brought under this section, a supplier may, before trial or within 30 days after a judgment of liability in the case of a separate trial on the issues of liability and relief, submit to the district court a plan for relief for consumers injured by the unfair consumer practice and on whose behalf the action is properly maintained. Such a plan may be approved by the district court if the court finds that such plan will reasonably assure that:

(1) it will administered in a fair and impartial manner and adequate funds will be made available to pay for the costs and expenses of maintaining and administering the plan:

(2) reasonable notice will be provided to consumers who may have been damaged by unfair consumer practices;

(3) aggrieved consumers will be afforded an opportunity to apply for relief within a reasonable time, not in excess of one year from the date of approval of the plan; and

(4) adequate funds will be available, or other adequate arrangements will be made, for relief through the plan, and for this purpose a bond may be required.

Promptly upon the filing of a plan the supplier shall cause to be issued public notice as approved by the court advising of the submission of the plan. Within 20 days from the publication of such notice persons who may be financially interested in the proceeding may submit written comments on the adequacy of the plan to the court. Any party to the action may request a hearing on the adequacy of the plan.

Upon approval, such plan shall be entered as part of a final judgment and decree and the court shall retain jurisdiction to the extent necessary to supervise its operation. In the course of supervising the plan, the court may hold hearings and issue orders and opinions.

JUDGMENT IN FAVOR OF THE UNITED STATES AS EVIDENCE

SEC. 7. A final judgment or decree rendered in any proceeding brought by the United States under section 5 of this Act to the effect that a supplier has engaged in an unfair consumer practice within the meaning of this Act shall be prima facie evidence against that supplier in any action or proceeding brought by any consumer against the supplier under section 6 of this Act, as to all matters respecting which said judgment or decree would be an estoppel as between the supplier and the United States: *Provided, however,* That this subsection shall not apply to consent judgments or decrees entered before any testimony has been taken.

VENUE

SEC. 8. An action under this Act may be brought in any district in which the claim arose or in which the supplier resides, is found, has an agent, is licensed to do business, or is doing business.

LIMITATIONS OF ACTIONS

SEC. 9. Any action under section 6 of this Act shall be brought within one year after the termination of the proceeding under section 5 of this Act or under section 5 of the Federal Trade Commission Act on which it is predicated.

CIVIL INVESTIGATIVE DEMANDS

SEC. 10. (a) Whenever the Attorney General has reason to believe that any person under investigation for any violation of the provisions of this Act may be in possession, custody, or control of any documentary material, or may have knowledge of any fact, relevant to an unfair consumer practice within the meaning of this Act, he may, prior to the institution of a civil proceeding under section 5, issue in writing, and cause to be served upon such person, a civil investigative demand, requiring such person to produce the documentary material for examination or to answer in writing written interrogatories pertaining to such knowledge.

(b) Each such demand shall—

(1) state the nature of the conduct alleged to constitute the unfair consumer practice which is under investigation;

(2) describe the class or classes of documentary material to be produced thereunder with such definiteness and certainty as to permit such material to be fairly identified;

(3) propound with definiteness and certainty the written interrogatories to be answered;

(4) prescribe a return date which will provide a reasonable period of time within which the material so demanded may be assembled and made available for inspection and copying or reproduction or within which the interrogatories propounded may be answered; and

(5) identify the custodian to whom such material shall be furnished, or the person to whom such answers shall be made.

(c) No demand shall—

(1) contain any requirement which would be unreasonable if contained in a subpoena duces tecum issued by a court of the United States in a proceeding brought under section 5 of this Act or if propounded in an interrogatory directed to a supplier in any such proceedings; or

(2) require the production of any documentary evidence, or the disclosure of any information, which would be privileged from disclosure if demanded by a subpoena duces tecum issued by a court of the United States, or by an interrogatory propounded, in any proceeding under section 5 of this Act.

(d) Demand may be served at any place within the territorial jurisdiction of any court of the United States.

(e) Service of any such demand or of any petition filed under subsection (f) of this section may be made upon a partnership, corporation, association or other legal entity by—

(1) delivering a duly executed copy thereof to any partner, executive officer, managing agent, or general agent thereof, or to any agent thereof authorized by appointment or by law to receive service of process on behalf of such partnership, corporation, association or entity;

(2) delivering a duly executed copy thereof to the principal office or place of business of the partnership, corporation, association or entity to be served; or

(3) depositing such copy in the United States mails, by registered or certified mail duly addressed to such partnership, corporation, association or entity at its principal office or place of business.

(f) A verified return by the individual serving any such demand or petition setting forth the manner of such service shall be proof of such service. In the case of service by registered or certified mail, such return shall be accompanied by the return post office receipt of delivery of such demand.

(g) The provisions of sections 4 and 5 of the Antitrust Civil Process Act (15 U.S.C. 1313, 1314) shall apply to custodians of material produced pursuant to any demand and to judicial proceedings for the enforcement of any such demand made pursuant to this section: *Provided, however,* That documents and other information obtained pursuant to any civil investigative demand issued hereunder and in the possession of the Department of Justice may be made available to duly authorized representatives of the Federal Trade Commission for the purpose of investigations and proceedings under the Federal Trade Commission Act.

REPORTS BY THE ATTORNEY GENERAL

SEC. 11. The Attorney General shall annually report to the President and to the Congress on the effectiveness of this Act.

OTHER LAWS NOT AFFECTED

SEC. 12. This Act shall not annul, alter, or affect in any manner the meaning, scope, or applicability of any Federal or state law, including but not limited to laws concerning the provision of goods and services to consumers and the Public Health Cigarette Smoking Act of 1969.

SEPARABILITY

SEC. 13. If any provision of this Act is declared unconstitutional, or the applicability thereof to any person or circumstance is held invalid, the constitutionality of the remainder of the Act and the applicability thereof to other persons and circumstances shall not be affected thereby.

Senator Moss. Because we have an extensive record on this subject, we have asked witnesses to focus their oral testimony on new material—points not already in the record. Further, in consideration of the number of witnesses we have and our limited amount of time, we have asked witnesses—other than Mrs. Knauer and Mr. McLaren, of course—to limit their testimony to about 10 minutes. Statements may be submitted to be printed in the record in full.

We are most pleased this morning to have with us Mr. McLaren, the Assistant Attorney General in charge of the Antitrust Division, and Mrs. Knauer, who is Consumer Advisor to the President of the United States, in the executive department, and others that they have brought with them.

We are going to call on them first—but perhaps my colleague, Senator Hatfield, may have some opening statement he would care to make?

Senator HATFIELD. No, Mr. Chairman, I have no opening statement.

I will say that the quotation from Judge Solomon certainly bears a great deal of weight with me because of the fact he has been running a very effective U.S. district court, in Portland for many years, and, therefore, I am pleased to see his testimony before us in this quotation.

Senator Moss. Thank you, Senator Hatfield. We are glad to have you sitting with us this morning.

This committee will give very prompt attention to the bills that we have before us.

Now we welcome Mrs. Knauer and Mr. McLaren and their assistants this morning. You may proceed.

I suppose "ladies first," so we will call on Mrs. Knauer.

**STATEMENT OF HON. VIRGINIA H. KNAUER, SPECIAL ASSISTANT
TO THE PRESIDENT FOR CONSUMER AFFAIRS; ACCOMPANIED
BY LEWIS A. ENGMAN, GENERAL COUNSEL**

Mrs. KNAUER. Thank you, Mr. Chairman, Senator Hatfield.

May I first introduce my general counsel, Lewis Engman.

Senator Moss. We are very glad to have you again with us.

Mrs. KNAUER. I am happy to be here to testify in support of new legislation to strengthen Federal fraud prevention statutes, and give consumers rights to undertake actions for violations of Federal fraud prevention law.

We all agree, I believe, that we need more effective action to curb consumer fraud and deception. Fraud and deception in the marketplace victimize us all, but particularly the poor, the uneducated, and the elderly. It undercuts those who attempt to give the customer his money's worth, representing honestly what they have to sell. It leads to widespread and substantial economic waste, in purchases of useless goods and services, and in misdirected purchases.

Although we all agree on the goal, there is not full agreement on the specific means of reaching the goal. We are discussing legislation again this year, instead of having a law on the books, for a number of reasons. Widely varying approaches were presented to the Congress last year. The issue does involve large volumes of commerce—applying to almost all consumer goods and services. Legislation allocating rights and duties on mass transactions will have considerable impact on the marketplace. Some care in resolving the issues involved is required.

And, we do confront a significant degree of uncertainty about what constitutes the best machinery for handling large masses of

small claims. Class actions are one possible device. But judicial procedure for handling class actions has been in a state of evolution. We do not have a great deal of useful precedent in the actual trial of massive actions of the sort which could be created in consumer suits of a national scale. The cost-benefit calculation of very large-scale class actions is not as clear as either the most ardent supporters or the most ardent opponents of the device contend.

In the last Congress, the administration proposed a bill to provide both for increased Federal enforcement action, through Justice Department suits, and for direct consumer remedies in the Federal courts. Many persons were critical of our measure, characterizing it as too limited. But we see that the bills now before this committee are similar in important respects to what we have proposed: most significantly, in itemizing offenses, and providing for limitations on standing, in recognition of the limited capacity of the Federal courts. We think these features are in the bills because they address real problems, and reflect considerations which should be taken into account.

While others have taken account of elements in our proposal, S. 1222 reflects our recognition of useful features in alternative proposals. We have adopted additions to the list of proscribed practices; inserted a provision for pretrial settlement of damage; and added a provision for civil penalties in the case of willful violations.

As a result, the bills before you are closer together than in the last Congress. Positions continue to differ, however, on two basic issues:

First, on whether the grounds for consumer suits should be specified in a self-contained list, or be open, through one device or another, to the full range of "unfair and deceptive" acts and practices under section 5 of the Federal Trade Commission Act; and

Second, on whether consumer suits should proceed only after a successful Government suit, or whether other jurisdictional tests should be used.

As to the first issue, we continue to support a self-contained, legislatively defined list. Our reasoning is basically as follows. Section 5 of the Federal Trade Commission Act was not designed to be a basis for settling disputes between buyers and sellers. A more precisely delineated statute is needed for that purpose. We need a law which will give both consumers and businessmen a reasonably clear guide as to what their respective rights and obligations are. We do not want to create a large mass of ill-conceived, costly, and unproductive litigation. The individual consumer inescapably pays the bill for ill-conceived and unproductive litigation, in the costs of goods and services, in taxes, and in foregoing better employment for the labor spent. We think most consumer abuses can be, and have been, defined at the level of specificity embodied in S. 1222. We have been flexible in adding items to the "laundry list," and so has Congress. We have reason to believe that if, contrary to expectation, experience under the law shows that we have missed a significant sector of consumer abuse, the Congress can add the requisite language with reasonable dispatch.

As to the second point, standing to sue, we continue to prefer the administration approach. Again, let me point out that we do not

have a great deal of experience with massive class actions. There continues to be a good deal of disagreement over the proper jurisdictional tests. Our approach, in S. 1222, will open up this area more than it has been open heretofore. We would prefer to have a workable piece of legislation now, and later to build on experience.

If we are going to rely on the large-scale consumer suit device for redressing the effects of deception in the marketplace, we must make the device workable. It must be manageable by the Federal judiciary. It must be fair, and balanced. It should be reasonably efficient, focusing private and judicial energies on cases of importance to consumers, and avoiding dissipation of those energies on trivial or ill-founded suits. If the legislation does not meet these criteria, the consumer will lose, not gain, from our efforts. The administration's approach meets these criteria.

In conclusion, let me say this. If we are going to move this matter, not just argue over it, we are going to have to prevent various notions of what might be thought theoretically best from becoming fatal enemies of the good.

We have put a progressive measure before you. It is feasible; it is practical; it will work; it will improve consumer welfare. You have given it considerable attention. But now there is a need to settle on something the Congress as a whole will pass; a bill that can start protecting consumers soon. We think the administration's measure is that kind of bill. We designed it with that goal in mind. We hope you will agree with us, and a measure of the sort we recommend can be enacted in this Congress.

I have discussed the legislation before you in general outline, stating our overall views on basic issues. I will now defer to Mr. McLaren, who will discuss detailed provisions of the bills before you, dealing particularly with aspects of enforcement and judicial administration.

Senator Moss. Thank you, Mrs. Knauer. We will be glad to hear from Mr. McLaren and then ask our questions of either of you if we have some to propound to you.

We are very glad to have you with us again, Mr. McLaren. I see you in far places like Seattle and elsewhere. We are pleased to have you before the committee again.

STATEMENT OF HON. RICHARD W. McLAREN, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE; ACCOMPANIED BY BRUCE B. WILSON, CHIEF, CONSUMER AFFAIRS SECTION

Mr. McLAREN. Thank you, Mr. Chairman. I appreciate very much the opportunity to come before this subcommittee today.

With me is Mr. Bruce B. Wilson, head of our Consumer Affairs Section in the Justice Department.

Senator Moss. We are glad to have you, Mr. Wilson.

Mr. McLAREN. I will proceed directly to the matters that the chairman has mentioned.

I know that the subcommittee is very familiar with the three pending bills. Each of them is an attempt to deal with what has un-

fortunately become a relatively common problem in the modern marketplace—that is, the problem of consumer fraud. And I know that the subcommittee is very conscious of the burden that this problem places upon consumers, the distortion it creates in our economic system, and the need that exists for sound legislation. So I will move directly to the discussion of the bills.

Senator Moss. That may be done. And of course, your prepared statement will be in the record in full.

Mr. McLAREN. Thank you, Mr. Chairman.

First I would like to outline briefly the principal provisions of S. 1222, which, of course, is the administration bill. In shaping these provisions, we have followed the same general scheme that the Congress adopted in the Clayton Antitrust Act. The Clayton Act spells out certain substantive offenses and provides for coordinate enforcement activities on the part of both the Federal Trade Commission and the Justice Department. Section 2 of S. 1222 sets forth the substantive offenses which would be prohibited. These 14 practices are well known to be unfair and deceptive under section 5 of the Federal Trade Commission Act, as the law under that act has been developed by the Commission. The practices are spelled out in some detail in order to give businessmen adequate notice with respect to conduct which will subject them to penalties and suits for damages.

Section 4 of the bill authorizes the imposition of civil penalties of not more than \$10,000 for each act in violation of the statute. This is new, and was not a provision of last year's bill.

In addition to FTC proceedings, the Justice Department would be empowered to bring court suits against such practices, and to obtain preliminary injunctions to put such practices to a prompt end (section 5).

The Department would be given investigative authority similar to that of the Antitrust Division under the Antitrust Civil Process Act. This would enable the Department to make speedy and accurate investigations (section 10).

Upon the entry by a court of a consent decree or a final decree after adjudication, or upon the entry by the Federal Trade Commission of a consent order or a cease and desist order against a violation of the Consumer Fraud Prevention Act, injured consumers could bring their own suits to recover damages, to obtain rescission of contracts, or to obtain other equitable relief (section 6). These relief provisions are expanded upon from last year's bill. The provision in 6(c) of this bill for a supplier to submit a plan of settlement is also a new provision.

If a court has adjudicated that the defendant has committed an unlawful practice under the act, the judgment will be *prima facie* evidence of the violation in the consumers' suit.

Under rule 23 of the Federal Rules of Civil Procedure, consumers would be able to bring suit as a group when the unlawful practice has damaged a substantial number of them, and when the other requirements for a class action are met. Since this is a statute regulating commerce, they need not meet any requirement for jurisdictional amount to bring suit.

S. 984 and S. 1378, Senator Magnuson's bill and Senator Bayh's bill, seek to accomplish these consumer protection goals by somewhat

different means, I would like to mention how these bills differ from the administration's bill in four respects: First, their definition of what constitutes an unfair consumer practice; second, the enforcement mechanisms which are provided; third, the effect which is given to a decree in a governmental proceeding in a subsequent suit by consumers to recover damages; and fourth, the provisions for private relief.

Turning first to the definition of "unfair consumer practice," S. 984 and S. 1222—that is, Senator Magnuson's bill and the administration's bills—are very similar in their definition of what constitutes an "unfair consumer practice." We question, however, the inclusion in S. 984 of section 101(1) (P), which would give consumers a right to bring actions in the Federal courts for any violation of section 5(a) of the Federal Trade Commission Act which is unfair or deceptive to the consumer. One of the great virtues of the FTC Act has been that the Commission's decisions operate prospectively only. The Commission has thus been able constantly to explore new areas of commercial practices which may result in unfairness to consumers. In contrast to the other practices which would be made unlawful by the bill, which are carefully spelled out in order to give adequate notice to potential violators, subsection (P) would incorporate a great number of undefined offenses under the Federal Trade Commission Act. It thus seems inappropriate as a basis upon which to award damages and other affirmative relief.

The same comments would be applicable, and to an even greater extent, to the provisions of S. 1378, which would permit actions to be brought for violation of an FTC rule, as well as a violation of section 5 of the act.

The definition of the term "unfair consumer practice" contained in S. 1378 differs in additional major respects from those contained in S. 1222 and S. 984. For example, subsection (C) of this bill would prohibit the making of inaccurate statements concerning the need for repairs, whether or not those statements were made pursuant to a good faith belief that the repairs were, in fact, necessary. Similarly, subsection (F) would flatly prohibit representing "that goods are of a particular standard * * * when they are not," regardless of the seller's good faith belief. We do not believe that such absolute prohibitions—prohibitions against conduct which might not be fraudulent—are appropriate or necessary to deal with the problem of consumer fraud as it exists in the marketplace today.

The term "unfair consumer practice," as set out in S. 1378, also includes "violations which give rise to civil liability under State statutory or decisional law for the benefit of consumers." Because the commission of an unfair consumer practice would give rise to a right to bring actions in the Federal courts, this proposal would require the Federal courts to entertain and administer litigation arising from an undefined and potentially very broad range of laws. Federal court actions could thus be based not only on unfair trade practice laws, but also on State utility laws, health and safety laws, usury laws, landlord-tenant laws, and the like. We believe the imposition of such a broad range of additional litigation on the Federal courts—which are designed to be courts of limited jurisdiction—would be unwise.

On balance, the definitions of unfair consumer practice contained in S. 984, with the exception noted previously, and in S. 1222, we believe are much to be preferred over that contained in S. 1378.

With respect to providing additional governmental mechanisms to enforce laws against consumer fraud, S. 1222 would give the Department of Justice new tools to deal with this problem. Neither S. 984 nor S. 1378 would provide such additional Government enforcement, preferring to rely instead upon the current enforcement activities of the FTC and upon private enforcement.

It has been our experience, as well as that I believe of the FTC, that Government enforcement is an essential part of any consumer protection program. Many of the worst consumer frauds are perpetrated by fly-by-night operators who do not have the resources to pay even a small amount of damages in a private action. We have found, for example, that many defendants in cases we bring to assess civil penalties for violations of FTC orders cannot pay even a modest penalty except on an installment basis. To such judgment-proof operations, the threat of private damage actions is meaningless. The result would be that the whole enforcement load would be placed on FTC. To the extent that it could not cover the whole country, some of the most egregious cases of consumer abuse might go undeterred.

Accordingly, we believe that new laws against consumer fraud should provide for substantial additional Government resources to be committed to their enforcement. We, therefore, support the provisions of S. 1222, which would enable the Department of Justice—with its 93 U.S. attorneys' offices—as well as the FTC to bring actions for injunctive relief to put an end to consumer frauds.

Turning now to the provisions concerning the effect of Government judgments, S. 1222 provides that where, in an action brought by the Department of Justice, a court has determined that a defendant has committed an unlawful consumer practice, its judgment would be *prima facie* evidence in any subsequent suit brought by consumers. S. 984 would give such effect to orders of the FTC, provided that such orders were based upon a preponderance of the evidence and entered after an evidentiary hearing. S. 1378 does not contain comparable provisions.

In framing S. 1222, we considered whether it might be possible to give such *prima facie* effect to orders entered in FTC proceedings, as well as those entered in court actions brought by the Department of Justice. However, we foresaw potential problems arising from the facts that (1) the Commission's orders may be sustained upon appellate review if they are based upon substantial evidence rather than on a preponderance of the evidence; (2) evidence received in Commission proceedings is not necessarily competent evidence, as required in a court of law; and (3) defendants would argue—with some justification—that their right to a trial by jury was prejudiced under such a rule.

Thus, if such an FTC order were to be evidence, the court in which the action was pending might well have to undertake an independent review of the Commission's proceedings, including the entire record, in order to determine whether the order was in fact based upon a preponderance of the competent evidence. We believe

that this requirement would tend to delay substantially the proceedings in the district court. On the other hand, to preclude this type of review would result in possible unfairness to defendants. In view of these problems, we recommend according *prima facie* effect only to judgments entered in court proceedings brought by the Department of Justice.

Turning now to the provisions for private actions, S. 984 would authorize consumer class actions in the Federal district courts for damages and equitable relief for consumers who have sustained damages in excess of \$10. Similarly, S. 1378 would authorize such class action suits where the amount in controversy might reasonably be expected to exceed \$25,000. In addition, S. 1378 would create concurrent State court jurisdiction, directing the State courts to apply the provisions of Federal Rule of Civil Procedure 23, the class action rule. S. 1222 would provide that, if an action by the Federal Trade Commission or the Department of Justice were resolved in favor of the Government—whether after trial or by consent decree—injured consumers could then bring both individual and class actions to recover damages or other appropriate relief.

The proposal of S. 1222 that the Federal Government must first proceed successfully against a particular consumer fraud before consumers may sue for damages in the Federal courts has been the subject of substantial controversy. I think, however, that it is important to understand the rationale behind this proposal, because this rationale is in large part a reflection of our thinking with respect to the appropriate roles of the Federal Government and of the States in the area of consumer protection. Where a substantial number of consumers have been injured on a regional or national basis, we think it entirely appropriate and, indeed, mandatory, for the Federal Government to act. In such instances, the mechanism of the class action under rule 23, cumbersome though it is, may be the most efficient means of resolving the claims of a large number of people.

Responding directly to the chairman's opening remarks, we are not by any means against class actions as such, but we are concerned that the Federal courts may be given the burden of resolving controversies which properly belong in small claim courts.

If a consumer fraud is primarily intrastate or local, we believe it should be dealt with by State and local consumer protection agencies. Moreover, consumer claims arising from such frauds are, we believe, more appropriately and efficiently dealt with in the state and local courts. The so-called Government-trigger provision is an attempt to distinguish between these two types of cases.

Beyond this fundamental division of labor, we believe that any proposal for consumer actions must be manageable in the Federal Courts, effective for consumers, and fair to business. We question whether any of these requisites are met by the unlimited class action proposals of S. 984 and the relatively unlimited provisions of S. 1378.

Proposals to permit consumer class actions in the Federal courts are frequently referred to as devices by which consumers can band together to pool their resources and pay for legal costs. These descriptions would be appropriate if we were dealing with the provi-

sions of rule 23 before they were amended in 1966. Prior to 1966, a class action was simply a device for permissive joinder—that is, persons with similar claims could join together and assert those claims in a single action. No one who was not a party could recover damages and no one who was not a party was precluded from bringing his own suit in the event the decision was adverse to the claims asserted.

The 1966 revision of the rule changed all this. The class-action mechanism was transformed from a mere permissive joinder rule into a device whereby the rights of parties not actually before the court were to be decided. This transformation raises a number of problems in connection with class actions on behalf of consumers.

The problem of manageability of class actions and the question of providing effective relief for consumers are to some extent intertwined. A lawsuit which is unmanageable is not going to provide effective relief. Rule 23 specifically directs the judge to consider the question of the difficulty likely to be encountered in management of the case in deciding whether to permit an action to be maintained as a class action. If, in his discretion, he concludes that a class action would not be manageable, the result may be dismissal of the case and no relief for consumers.

This is precisely what happened recently in a case brought before a Federal court in Philadelphia on behalf of a class of 1.5 million people, seeking to recover overcharges on bread as a result of a price-fixing conspiracy. The court concluded that the class is "so large that it would be unmanageable and could only result in many knotty, complicated, and unnecessary problems." A class action on behalf of every individual purchaser of gasoline in Hawaii was dismissed for the same reason. That court concluded that "the problem of management of the proposed class is clearly insurmountable."

I might advert to some of the problems of manageability which seem to be troubling the courts. One quite clearly is the problem of giving adequate notice to potential members of the class. Notice of the action is necessary in order to satisfy the requirements of due process, since the judgment will at least purport to decide the rights of absent members of the class. Notice must also be given to members of the class of any proposed dismissal or settlement of the action.

In a large consumer class action, the giving of adequate notice is more than a legal problem. There are practical problems as well, not the least of which is cost. In class actions brought against the manufacturers of the antibiotic drug tetracycline, the cost of giving a single notice to members of the class was in excess of \$300,000.

A second difficulty is the problem of deciding how to distribute any fund which becomes available to plaintiffs in class action suits, whether by judgment or through settlement, where the claims of the plaintiffs are of different amounts. If all the claims are the same, the problem is alleviated; the fund can simply be divided equally. However, where different members of the class have expended differing amounts as a result, for example, of a particular fraudulent practice, each plaintiff must be presumably—absent some agreement to the contrary—make at least a minimal showing of the amount in which he was damaged.

As the size of a consumer class action increases, involving perhaps millions of consumers, the problems of notice and distribution, and of manageability in general, become even more acute.

Up until now, we have been talking about the problems of management associated with a single class action. We should also consider the question of manageability in terms of the additional burden which unlimited consumer class actions would place upon our federal court system. The Federal courts are courts of limited jurisdiction, with a limited number of judges. They deal with vitally important questions affecting our Federal system of government and a great number of similarly important questions arising under Federal legislation. To allow unlimited access to these courts by consumers who have what are essentially small claims does not seem to be a wise use of our Federal judicial manpower.

Again, the question of whether class actions are going to be an effective consumer remedy depends upon the ability of the Federal courts to process such actions. As a result of overcrowded dockets in the Federal courts, even ordinary civil actions are presently subject to substantial delays. This is especially true in our major metropolitan areas where one might expect the largest number of consumer class actions to be brought. For example, it takes some 41 months to get to trial in Philadelphia; 33 months in New York; 28 months in Brooklyn; and 27 months in Detroit. It can be expected that large class actions would take even longer to process than the routine civil case.

Permitting unlimited consumer class actions would simply increase the congestion which already exists. The result might well be that what the consumer would receive from this approach would be a small piece of a 5- or 6-year lawsuit, rather than an effective remedy. Even today, class actions hardly bring speedy relief. In the tetracycline cases, to which I referred earlier, there still has been no distribution pursuant to a settlement offered by the defendants—with the money now put in escrow, incidentally—more than 2 years ago.

In addition to being manageable in the Federal courts and effective for the consumer, any new Federal consumer remedy should also be fair to business. Businessmen should have clear notice as to the types of conduct which will subject them to suits for damages. Moreover, care must be taken to avoid the possibility of strike suits against legitimate business. To the extent that businessmen incur legal costs from unwarranted suits and perhaps enter into settlement of such in order to avoid the rigors and risks of litigation, the prices charged by these businessmen are necessarily going to reflect these unwarranted costs.

In consumer class action, it is quite likely that the lawyers handling the case for the plaintiffs have the largest single interest in the litigation. Recognizing this, the Judicial Conference Coordinating Committee recently publicized its deep concern that situations like this led to unethical solicitation. Quite clearly, also, situations like this can lead to the bringing of strike suits in hopes of quick settlements and substantial fees.

In summary, I do not see that the class action is anywhere near the panacea for the woes of consumers that some consumer advocates

have claimed. Where the government has first proceeded against the perpetrator of a fraudulent or deceitful practice, I think that the class action can be an effective remedy. The government will, at the very least, have outlined the elements of the offense in its complaint. If the case has proceeded to trial, the plaintiff will have the benefit of a judgment in favor of the Government as evidence. Strike suits will be avoided and the Federal courts will be reserved for those consumer class actions which ought to be brought in the Federal courts—that is, against those frauds which have affected a substantial number of consumers on a national or regional basis.

The Uniform State Law Commissioners have proposed a model state consumer protection law, and it is our strong feeling that, absent FTC or Justice action, the state courts are where local claims should be adjudicated. Moreover, the recent creation of a National Institute for Consumer Justice, to study means of resolving consumer disputes, should give us greater insight into the most appropriate means of satisfying legitimate consumer claims.

Thank you, Mr. Chairman, for your patience.

Senator Moss. Thank you, Mr. McLaren, for your full and complete statement on this matter. We are glad to have it before us because this is the problem we are faced with in marking up the three bills that are before us.

I know that Senator Hatfield will have to leave a little early here.

Do you have any questions you would like to ask first?

Senator HATFIELD. That is very kind, Mr. Chairman. I do have two or three brief questions.

Senator Moss. You may go ahead.

Senator HATFIELD. Thank you very much, Mr. Chairman.

First I have a brief question I would like to ask Mrs. Knauer. I appreciate very much the testimony that you have given here this morning. Mrs. Knauer. It has been very clear and very succinct.

I was pleased to notice that the administration's bill, S. 1222, has adopted a provision for a pretrial settlement of damage claims. Mrs. Knauer, would it not be even more useful if a mechanism could be devised whereby the claims between consumers and suppliers might be settled without even going to a court? Can you conceive of a mechanism? Or is it possible to develop a mechanism that might avoid a lot of this court action?

Mrs. KNAUER. Yes, Senator. I think you are referring to voluntary settlement without resort to courts or governmental action. This, I understand, is one of the areas to which the National Institute for Consumer Justice is addressing itself.

Senator HATFIELD. Well, then, one follow up question on that. Would you not agree, too, that perhaps within any of these claims there ought to be adequate provision given so a defendant or a potential defendant might be given every opportunity to settle the claims against him before a court action is brought?

Mrs. KNAUER. Yes; I think that would be desirable.

Senator HATFIELD. In other words, a voluntary settlement.

Mrs. KNAUER. Yes; I think so.

Senator HATFIELD. Would you endorse such a provision that would make this a legal requirement?

Mrs. KNAUER. I would have to defer to Mr. McLaren for any definite recommendation. Personally, I think that it might be an excellent addition.

Senator HATFIELD. You support the principle. On the legal aspect of this, you would defer to the legal experts—of which I am not one.

Mr. CHAIRMAN. I would like to ask Mr. McLearen two or three brief questions.

Relating to the seller's good faith comment in your statement:

Similarly, subsection (F) would flatly prohibit representing "that goods are of a particular standard *** when they are not," regardless of the seller's good faith belief.

You are analyzing these two bills in this statement.

Mr. McLAREN. Yes.

Senator HATFIELD. Mr. McLaren, how would this affect a situation where you have, as in the pharmaceutical industry, retail salesmen who are representing the claims of the manufacturer as an employee of that manufacturer to sell to a retail drug outlet, and then the retail druggist is in turn selling these items to the public. Under a consumer action here, what are the relative liabilities or responsibilities, say, of the retail druggist and the retail salesman representing the manufacturer? Where do we identify the seller's good faith, and who bears what responsibilities here in such a class action?

Mr. McLAREN. Well, Senator, I think that is covered in the definition of the term "knowingly." There must be knowing misrepresentation. In other words, we are dealing with questions of fraud here. Therefore, I would think the answer to your question is: Unless the druggist knew that he was passing on something that was false, that he would not be subject to this act, and neither would the retail man if he had no reason to think that he was passing on something that was untrue.

The suit brought against the manufacturer would come to a question of whether he has sound bases for making the claims. Perhaps he has tests and so on. But the point I was reaching here is that perhaps other tests show that his tests were wrong. It would be a close question.

But under subsection (F) to which you refer, as I understand it, it would not really require the fact that he knew he was wrong. It puts an absolute duty on him to be right. I think that this is an unduly difficult standard for him to meet.

Senator HATFIELD. As you know, it becomes increasingly difficult in an area, particularly with drugs, where you are dealing with generic versus brand names. The claims of brand-name drugs often can be supported with great scientific experiment, scientific study, and thereby, price ranges reflecting that kind of investment by a private investor, as over and against, say, the generic drug which would be sold at much less cost, and yet, compoundwise, from a purely "chemistry" approach, one could prove the ingredients are the same. As you know, we are involved in that problem today in the Congress. It is trying to delineate between the claims of the generic drug versus the brand-name drug.

How do you get at this? Certain claims and certain therapeutic values are claimed with brand names, which people from the other

side of the case can argue, "Well, but that is misleading the public because the same thing can be obtained through a generic drug at one-fifth the cost or one-tenth the cost."

Now does this get involved in this matter of trying to define "knowingly," "misleading the public" and what-have-you?

Mr. McLAREN. I would not think that normal advertising, the pushing of your own product, would violate this kind of a fraud bill unless you in fact knew that you were misrepresenting.

It is similar to the situation in which the Department of Justice, brings an action to cancel a patent. If an applicant for a patent knowingly misrepresents to the Patent office facts upon the basis of which a patent is issued, the patent can be canceled.

I think that there has to be an element of *scienter*, as in the common law—knowingly and willfully.

Senator HATFIELD. Mr. McLaren, it gets really to somewhat a question of interpretation, does it not, because if you want to read some interesting testimony, I would suggest you read the testimony before Small Business Committee given by both the pharmaceutical industry in defense of their claims and their marketing procedures of certain brand-name drugs, and some of the counterchallenges or counterclaims by those representing support for generic drugs, because it borders—if not directly, on charges of misrepresentation and fraud. This is not in the advertising language alone, but combining that with the pricing practice, and combining it with the claims for the therapeutic values, and combining it with efficacy and combining it with the tests that are applied for protecting the various batches of these drugs—all of these combinations of charges and countercharges—I personally, as a nonlawyer, become very troubled as to exactly whether we are bordering on a case of fraud or not.

Have you seen any of that testimony?

Mr. McLAREN. I have not; but I have seen some of it reported, and I am aware of the controversy.

I think that this is a situation where I would say that the FTC is peculiarly set up to hold hearings as to whether or not fraud is involved or whether there is false and misleading advertising—and there is a difference, of course, between that and fraud—the FTC can stop it.

In these bills I think that we are trying to deal with clear fraud.

Senator HATFIELD. Well, I am not in a position to identify fraud or to charge it either. I am just saying that there is testimony that would border on what I think a reasonable man's definition of what fraud is; and it relates to this very question, especially as it gets into the respective responsibilities of the manufacturer, the salesman, the physician prescribing the drug, and the druggist, the local druggist who is dispensing it at the retail level.

One question, under S. 1222, as I understand your language here, the consumer would be totally dependent, before he could bring his class action, upon some previous action by a Federal agency. That is, either by the FTC or the Department of Justice or a court action of settling through a consent decree; is that correct?

Mr. McLAREN. That is in Federal court, Senator?

Senator HATFIELD. Yes.

Mr. McLAREN. Of course, I think all the States have laws against fraud, and some 30 of them have some sort of class action of joinder provision.

Senator HATFIELD. You are expressing concern here about the overcrowded dockets of the courts. What I want to ask you is what is the status of the 93 offices of the Attorney General's office? Just what kind of staffing do you have here that would provide a reasonable time factor for people to wait for this preliminary action on the part of the Justice Department? Are you well staffed to handle this? Or would you find yourself inundated, as you claim the courts would be under such consumer legislation?

Mr. McLAREN. We are proposing a coordinate jurisdiction between the Justice Department and the FTC. We would help the FTC with a burden that it already has. We think we could speed up the process. We have people located strategically all over the country. In the kind of offense of fairly general or regional impact that the Federal Government should be concerned with, we believe that FTC and Justice together would be well able to handle it.

Senator HATFIELD. Do I understand then that you are presently staffed sufficiently to take on these added responsibilities? Is that what you are saying to the committee?

Mr. McLAREN. No; I do not mean to say that we have everybody we need.

We estimated, I believe, last year that we would start the first year with an office of about 30 people in the Justice Department in Washington.

Senator HATFIELD. Additional?

Mr. McLAREN. Additional to the group we now have.

We would then know by workload how many additional people we would need. We have already set up a consumer affairs section, and we have pretty well concentrated in this section other consumer responsibilities that the Justice Department has; this is the section of which Mr. Wilson is the head.

Senator HATFIELD. Two points concern me, first, whether or not you would have appropriate staff—and you say you would have to add additional staff.

The second thing that concerns me about your proposal at this point is how dependent is this upon the philosophy of an administration? By that I mean do we depend here upon the strict constructionist versus the other kind? Do we depend here upon the aggressiveness or lack of aggressiveness, or the lack of interest or the deep interest of an Attorney General? Does this really come down to one man? Are we going to have to wait to find out what John Mitchell really believes before we see the action throughout these 93 offices? That is basically the question.

Mr. McLAREN. No; I do not think there is really any question, nor would there be from one administration to another, on any question of fraud. Where you are able to find evidence of fraud, you proceed.

Senator HATFIELD. Here again I am a layman, but I am not very impressed at this point with the action of the Attorney General's office in segregation cases and civil rights cases, and yet the law is very clear in my eyes as I read the law. Here we come back to

this matter of aggressiveness or interpretation by an Attorney General. I am asking just a simple question: Are we going to have to depend upon one man, as we obviously have done to establish the pace, the trend, and the philosophy of administering civil rights legislation, in the area of consumer rights?

Mr. McLAREN. Senator, I wish I were better prepared to answer that; but I know that there are data showing that this administration has brought more cases and had a better track record in segregation and civil rights than any other administration ever had.

Senator HATFIELD. I have heard statistics—

Mr. McLAREN. When we came into office there were no plans to carry out desegregation in a lot of Southern States. I am not fully prepared to address that point; but I think that it can be fully addressed. I am prepared to defend our record in the antitrust field, and I think that this is beyond anything any administration has done for quite some number of years.

Senator HATFIELD. I have heard this administration quote statistics about everything, from reduced casualties in Vietnam to the statistics of their cases before the courts on civil rights. I do not think statistics alone tell the story. And I think if you want to really find out about the civil rights thing—and that is not the subject before us; it is only illustrative of why I am asking the question—if you really want to get to the heart of the civil rights program in this country, I would suggest you get in tune with the civil rights leaders of this country and see what their views are about how aggressive the administration has been. But that is another subject.

I am just concerned about whether or not we are going to force the consumer into a position where he is dependent upon his rights being triggered by an action of the Attorney General's office before he can bring his own case and class actions; whether or not we are back to the point of being dependent upon one man's viewpoints, one man's philosophies, one man's interpretation. Frankly, I am tired of government intervening between the citizen and his rights in court. This is why I just do not want to see the citizen placed in that role where he has to be dependent purely on the actions of a Federal officer before he can bring his own action in our courts.

We find this is increasingly so, even in the environmental area. We had a hearing here the other day about the Great Lakes and how people were concerned that they were so dependent upon a Federal agency's action. They were asking a committee upon which I sit to approve legislation giving to the citizen the right to go to court to seek certain enforcement of environmental violations.

In this particular case they were complaining about, there was even a Federal permit under which this industry was operating, given by the Corps of Engineers, which precluded the citizens from getting redress.

I think it is a very profound problem we face here, of placing the citizen in a role and a relationship dependent upon some Federal agency or some Federal officer to trigger one action before he can bring his own. That is the only reason I am asking the question.

Mr. McLAREN. Well, Senator, I think that the basic question here is how much of a load are you going to put on the Federal courts. I

think that it would be a terrible mistake to make small claim courts of them, which an unlimited class action would do.

Second, we have found in our experience with rule 23, the class action provision, that it is a very long road when you move into Federal court with these very unwieldy class actions. We think you can do a better job for the consumer by far by following up on the State provisions. The uniform State law commissioners have already come up with a bill.

There are State laws now, some of them good, some of them poor. But progress is being made, and it is our view that where there is a national or a regional injury that involves a large scale fraud on the consumer, certainly the Federal Government should get into it—FTC or Justice should stop it there. Then there should be a Federal cause of action enforceable in the Federal court to provide restitution, rescission or whatever else is needed.

Senator HATFIELD. I appreciate your thinking on that, and I would agree with you, by and large, on the problems that relate to the Federal courts and their overloaded dockets. But that is the reason I asked Mrs. Knauer the question about these voluntary approaches, which I would like to see us really pursue in a very aggressive style and see about developing some devices that may not really be before us at this time.

Mr. McLAREN. I agree on that, too, Senator. There is an effort under way now by this task force, the National Institute for Consumer Justice, to explore that; and I think arbitration and machinery along that line provides a great deal of promise.

Senator HATFIELD. Thank you very much, Mrs. Knauer, Mr. McLaren.

Mr. Chairman, I appreciate the opportunity to ask questions which you extended to me at this time so that I may get on to another session.

Senator Moss. I appreciate your taking this time to ask the questions and to clarify the issues before us.

Senator Hatfield does have another commitment and I knew he had to leave. I wanted him to have this opportunity to ask some questions.

I have, perhaps, just two or three questions.

Following on somewhat the line of questioning of Senator Hatfield, your concern, Mr. McLaren and Mrs. Knauer, is that the Federal courts will in some way be inundated by these class action suits, and the cases might become unmanageable.

But in referring to year prepared statement, Mr. McLaren, you point out how the Philadelphia court concluded that the action was large and unmanageable in the bread case, and you have pointed to other actions where the Federal court—like the tetracycline case—is able to control the litigation before them.

What would there be in this class action bill that would deprive the Federal court of exercising that kind of jurisdiction?

Mr. McLAREN. I was speaking there, Mr. Chairman, of the ineffectiveness of the remedy. The Philadelphia people, if they had some other remedy to follow, lost a year to 2 years, and then the case was dismissed. If it was dismissed without prejudice, then per-

haps they will get a chance to start over in some other forum or in some other case.

I think, as I indicated in the prepared statement, that it is a question of effectiveness for the consumer, manageability by the courts, and fairness to business. All three of those things need to be attended to; unlimited class actions, I am afraid, do not do any one of the three.

Senator MOSS. Was not the bread case, in effect, triggered by the action already taken, by the finding that there had been a price-fixing conspiracy in that case? And then the class action suit followed on?

Mr. McLAREN. Yes, but there was not any trigger to it. They could have filed ahead of the Government's case.

Senator MOSS. But what I am trying to say is that the trigger mechanisms then does not cure the problem that arose in the Philadelphia case.

Mr. McLAREN. In other words, had the same thing arisen in a consumer class action, it might have resulted in the same way in a Federal court?

Senator MOSS. Yes.

Mr. McLAREN. That is probably true. However—

Senator MOSS. In a classic antitrust case, there is not any requirement for a trigger mechanism, is there?

Mr. McLAREN. No.

Senator MOSS. And so the individual, if he wishes, may proceed directly to seek his remedy, whether the Department has moved or not.

Mr. McLAREN. However, Mr. Chairman, I have here the record for the month of May 1970 for the District of Columbia Court of General Sessions, and there were 1,315 small claims filed just in that 1 month, which were substantially consumer claims. We have never had anything like that kind of an experience in antitrust. That is just one city for 1 month.

Senator MOSS. Well, of course, I do not foresee that this bill, if it became law—any of these bills—would necessarily supplant the small claims court that exists in, I guess most States now and in many smaller jurisdictions, municipality or otherwise.

But what we are talking about here are cases that are based on misrepresentation and fraud and are widespread, that applies to so many people that it is really an economy to bring them together in one case to be decided, rather than require them to go piecemeal in the courts of lower jurisdiction. If each one were the subject of litigation, they might consume much more time than if they could be dealt with as a class.

So I am not convinced that this is a bill that is going to load the courts. I think in some sense it may relieve some of the congestion in the courts.

Mrs. KNAUER, last year you seemed to believe that consumers did not have an effective way for recovering their losses. Is that still your thinking, that they do need some means of recovering these losses that are widespread?

Mrs. KNAUER. Yes, this is the administration's position. The National Institute for Consumer Justice is looking into other areas of

consumer relief; perhaps a better utilization of small claims courts where poor people who do not have a lawyer can walk in from the street and literally say "We have been victimized by this case." This would require an investigation of how to make these courts more useful to low-income people—and we think this may be an area that will be productive. We are looking forward, naturally, to this investigation on the part of the National Institute; and we hope that they will come up with some ideas.

I know they are also looking into what has been done in other countries; some other country may have addressed itself to this problem.

Senator Moss. What you are saying basically, philosophically, is that we ought to release the initiative, as it were, of the consumer himself rather than hold him in check behind some triggering mechanism before he can be released?

Mrs. KNAUER. No, I did not say that, Senator. From a practical, workable point of view, I feel that there should be some trigger in using the Federal courts or before using the Federal courts for the resolution claims under a class action; that the Federal courts should be maintained for cases of a broad national import or for large groups of citizens who have been defrauded.

But, again, class action is only one consumer remedy, and I am glad that the National Institute is addressing itself to other areas to bring consumers legal relief in situations arising out of problems in the marketplace.

Senator Moss. Is the trigger provision to protect the courts from being overburdened, or does it serve any other purpose beyond that?

Mrs. KNAUER. I think it certainly would prevent the courts from being overburdened, and it would be a better utilization of the courts' time so that they would address themselves to issues of national or regional importance.

This triggering device, as a result of action by the Department of Justice in S. 1222, would provide for prima facie evidence, as Mr. McLaren has discussed in his testimony, and it would certainly make for a very simple case on the part of the consumers if based on this prima facie evidence all they had to do then was say they bought the article and were thus defrauded. I think it would certainly bring them relief, to have this opportunity of a successful conclusion of a Government case.

Senator Moss. This triggering feature seems to be a main point of difference in the administration bill and the other bills that are before us. There are other differences, of course; but this seems to be the principal one. And yet before this committee we have had very little defense of the trigger mechanism except from the administration. Almost all of our witnesses have felt that it was more an impediment than an improvement of the method of proceeding; and I have been trying to determine what the real reason is for it, if it is other than just the question of whether the Federal courts might be overused.

Mrs. KNAUER. Well, for any additional reasons I would have to turn to Mr. McLaren on this.

I feel it is a necessary device to make the bill workable and to bring hope of immediate relief to consumers.

Senator Moss. Well, I accept what you say, and I, of course, also accept your statement that you believe that consumer losses through deception still have a very considerable magnitude in the market.

Mrs. KNAUER. We specified a clearly defined list of consumer abuses which we think should be clearly defined and made illegal.

Senator Moss. Mr. McLaren, I believe in the administration bill this year "insurance" has been excluded from the scope of the bill, and I believe last year your testimony indicated it should be included. Is there any reason for that change?

Mr. McLAREN. I had forgotten that it had been in there last year, Mr. Chairman. The general subject of insurance, of course, is a matter covered by a special statute leaving it to the States. The States, we have been advised, have established by and large very active State insurance commissions and so on. To include insurance would be duplication of the Federal and State laws, or else there would have to be preemption. Leaving it to the States seemed the best way to handle it. We have also not tried to cover in this bill small loans or credit, that are covered by other Federal law.

Senator Moss. Well, the situation has not really changed between this year and last? It is just the analysis that you have applied to the State action in the insurance field; is that right?

Mr. McLAREN. I think that is right.

Senator Moss. I wonder, would you support section 101(1) (P), the open-ended laundry list of S. 984, if it were modified to have prospective effect only; that is, so that no liability would arise from actions taken prior to a decision that the actions were unlawful under section 5 of the FTC Act?

Mr. McLAREN. I doubt it, Mr. Chairman. We have in our "laundry list" something on the order of 90 percent of the frauds that FTC and State consumer protection bureaus find. We think that that is a pretty high order of coverage, and that in a law that sets up civil damages and civil penalties, there ought to be definiteness; people ought to be fully forewarned of the kind of thing they could be sued for.

Now if it develops that the "laundry list" has missed some practice that ought to be covered, I think we ought to put it in there specifically rather than having it open-ended. To have it open-ended could result in a person following along on a particular course of action that the Federal Trade Commission eventually decides, is illegal. Then the person would find that for 3 or 4 years he has been in violation of the law although he did not know it and did not intend to be.

Mrs. KNAUER. Mr. Chairman, may I add, too, that where civil damages are involved, we feel that Congress has this responsibility to add to it, to amend it later, if necessary. That, as Mr. McLaren said, it should not be left to the whim of the FTC to at some future time define an illegal action.

Senator Moss. My question was, though, if this were amended so that it would not be retroactive—in other words, that there had already been a determination that the section 5 action was proper and had been upheld by a court action, would we then be free to proceed? And I appreciate your response to it. I think it is in there.

I have perhaps just one more question. I said we did not have much time, and I am taking a lot, and I do not mean to do that.

One of the drawbacks that you mentioned, and the one thing that you fear, Mr. McLaren, is that there may be a large number of what you called "strike suits" that might be brought perhaps under this class action bill. And yet section 102(d), at the beginning of page 8 in S. 984, reads:

If the court determines that any class action brought pursuant to this section has been brought frivolously, with knowledge that the claim lacks probable cause and with intent to harass or intimidate the defendant, the court may in its discretion award the defendant the cost of defending the suit, including a reasonable attorney's fee.

Is it your belief that the Federal courts would not exercise that jurisdiction and thus stop short the so-called "strike suits"?

Mr. McLAREN. There have been similar types of statutes which have been passed that, generally speaking, I think are not particularly effective.

A federal court never likes to make a determination that a suit has been brought frivolously or without any cause. And I think there are some statutes that provide for costs, particularly, or for the assessment of attorney's fees. These are much less drastic remedies than dismissal; and my belief and understanding is that these have been rather ineffectual.

Mr. Chairman, I would like to go back to the question a moment ago, and emphasize that it is not just the burden on the Federal courts—although I think that is a very, very definite factor here. I think that we should bear in mind that it is only in the most exceptional circumstances that Congress has seen fit to put anything alike this kind of responsibility on the federal courts. The FELA type case occurs to me. But I think this probably would be for more extensive and far more burdensome than FELA.

But aside from that, I believe that we would have the greatest difficulties and a very ineffective remedy for consumers. I know both bills say that they do not intend to supplant State actions or they do not effect other laws. But how can you have a Federal class action, national in scope filed, we'll say, in Chicago, and not have that affect, say, an action filed locally under a very good law in Massachusetts or in New York? The defendant has a right to be tried in one court and not to be exposed on two different grounds.

I think that we just ask for a great deal of trouble.

We either should have preemption in order to have it work out fairly, or there has to be some sort of mechanism for the local suits to be taken out of the Federal case. And I think in due course there are going to be adequate State remedies.

This is something this country has relied on for generations. There are in many States adequate State remedies, and I think we should leave the Federal courts for the more extensive actions where we have given them something to go with—that is, the record of Federal Government cases. We have good reason to believe that kind of case will be manageable.

Senator Moss. Well, I think what you say is true, that there are a number of States that have class action provisions and statutes that

can deal with the problem which can be used. I don't know why, though, it would necessarily preempt them if Federal courts had jurisdiction.

Take a Chicago case. Suppose you had a case in Chicago because it touched Massachusetts, Indiana, Utah, and California, and you could bring one class action in the Federal court. But suppose you had a different case where the people involved were Massachusetts citizens. I would expect them to choose the Massachusetts court then for various reasons because of its local impact in Massachusetts.

So I don't see why you can't have Federal jurisdiction and the State jurisdiction operating appropriately within their sphere.

Mr. McLAREN. I was posing the case where the Chicago suit encompasses the same cause of action that has injured Massachusetts citizens; Massachusetts citizens want to sue in the Massachusetts court. But others want to sue in the Federal case in Chicago. The Chicago suit purports to represent all members of that class—all consumers injured by that particular course of conduct. It might not be just Massachusetts. If it's fairly national in scope, there may be actions in 10 other States. This is a real difficulty.

Senator Moss. Why fragment it if there really is an injury that is very extensive that goes through several States and where consumers in a number of States are affected? Why fragment it into six or seven different actions, some of which may succeed and some may not, which gives a different result to different consumers. Why fragment it if it can be in effect consolidated? That's my point.

Mr. McLAREN. Without regard to whether or not you should take away the right of the people of Massachusetts to bring their own litigation, certainly it seems to me basic considerations of fairness would require that the defendants not have to defend against the same cause of action in both places.

Senator Moss. Well, the defendants in a Federal case would defend in one lawsuit. They wouldn't have to go to different states.

Mr. McLAREN. They would be in Massachusetts as well as in Illinois or wherever else they are sued.

Senator Moss. Yes, but suppose this is a manufacturer, and he has his plant in St. Louis or Chicago, isn't it more difficult for him to go to Massachusetts than have him defend in one place?

Mr. McLAREN. That's not his choice. Under all these bills he could be sued wherever he is found; that is what happens under the anti-trust laws. The Federal courts have devised the system—all in Federal courts—they have devised the system of consolidating.

Senator Moss. Of course there has to be a venue problem.

Mr. McLAREN. May I make one more comment? It's only last summer that the commissioners on uniform state law came up with their bill. I think the State legislatures' interest in this field has paralleled the interests of the Congress. I don't have the figures, but I believe that the record on adoption by the States of legislation suggested by the Uniform State Law Commission is very high. I would say very strongly that we ought to see how this develops from the state point of view. After all, we have both the State and Federal system, and I think they can live together.

Senator Moss. I do, too, and I certainly welcome action on the State level to compliment and fill out the jurisdiction exercised federally. I don't disagree with you at all on that. I don't know that we have to wait for them to go ahead, but that we ought to be going along the same general path.

Well, I appreciate your appearance here today, all of you, and we, I hope, have understood what you presented in your testimony. Certainly the committee will study it with great earnestness as we try to mark up our bill. Thank you very much.

Mr. McLAREN. Thank you very much.

Mrs. KNAUER. Thank you, Mr. Chairman.

Senator Moss. Mr. Sheldon Elsen, chairman of the Association of the Bar of the City of New York, and Mr. Stephen L. Kass, chairman, Special Committee on Consumer Affairs, Association of the Bar of the City of New York. Will those two gentlemen come forward, please?

We are pleased to have you.

STATEMENT OF SHELDON ELSSEN, CHAIRMAN OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK; ACCOMPANIED BY STEPHEN L. KASS, CHAIRMAN, SPECIAL COMMITTEE ON CONSUMER AFFAIRS

Mr. ELSSEN. I am Mr. Elsen.

Senator Moss. Glad to see you. You may proceed.

Mr. ELSSEN. Mr. Chairman, first I would like to ask the permission of the committee to introduce into the record a printed report of the Association of the Bar of the City of New York entitled "Proposed Federal Legislation to Protect Consumers, Including Consumer Class Actions." We have supplied several copies of that to the committee.

Senator Moss. It may be printed in the record after your oral summation and you may proceed to discuss it as you care to.

Mr. ELSSEN. I will not read a prepared statement but we will discuss orally certain of the key questions, and certainly will welcome questions as we proceed.

Mr. Chairman, first I should state, although I think it is known to the committee, but I think I should state, the Association of the Bar of the City of New York is an association composed of some 10,000 lawyers in the city of New York, and with members all over the country. I think it fair to say that it's probably the leading representative of the bar of the city of New York, and there are those who think that it's one of the outstanding bar associations in the country.

Now, the association has no ax to grind, no commercial or political ax to grind. When lawyers speak out in public, they are not representing clients but they are concerned with the public good and with the quality of the laws, and that is what our concern here is today. That's the concern expressed throughout this report. The association speaks on matters of Federal legislation through its Committee on Federal Legislation, of which I am the chairman, and the association has a special committee on consumer affairs, of which

Mr. Kass is chairman. He will address some remarks to the detailed points of these bills after I have made an introductory statement and talked about some of the more significant problems.

Now, I would like to say, I think the committee may be interested in the thought processes that went into this report. As you probably know, New York is the center of class action litigation. We had a great number of lawyers who have represented large corporations in these cases, who have represented plaintiffs, and creditors, who have represented neighborhood law offices, lawyers from all over the bar. I cannot think of any group which has had more experience with the type of problem which I think is of greatest concern to this committee. We have had four different committees concerned with this, almost a hundred lawyers. And, Mr. Chairman, I think you may know what is involved when almost a hundred lawyers get together on a controversial subject.

We debated these problems for months. Certainly the points which Mr. McLaren raised were before us, and they were sometimes vigorously expressed during what, I must say, were the earlier phases of our thought. And I think it's fair to say, though I certainly appreciate the quality of the thinking which has gone into his presentation, but I must say that after we had thought the problems through we came out the other way. We support this legislation.

We think that these problems can be resolved, and readily be resolved, and we think the underlying problems for the consumer which give rise to this type of legislation far outweigh the kind of problems which have been raised. They can be solved by lawyers who think about them. This was the unanimous report, Mr. Chairman, and that, I must say, is something that I—

Senator Moss. That is very unusual for a bar association.

Mr. ELSEN. That, Mr. Chairman—you know bar associations, and that is an extraordinary thing. But it reflects the amount of debate that went into the work.

Now I want to say as a summary of our position, two things: One, we firmly believe that the time has come for Federal class action legislation. These bills can provide a fair and effective response to this need.

Second, I want to point out that the four committees which prepared our report, Federal Legislation, Federal Courts, Consumer Affairs, and Trade Regulation, whose members were drawn from all over the bar, we believe that the varied experience and perspectives which these four committees bring to this issue will make their joint report a useful document for the Congress and for this committee.

Now let me turn first of all to the question of triggering, and then I am going to talk about questions of abuses and court congestion. After that Mr. Kass is going to go into many of the details of the bills, particularly S. 984, and S. 1378, which were the ones we had in advance of the hearing.

On the question of triggering devices, two agencies have been suggested as being the watchdogs of the public. The public, according to the administration, is to be barred from access to the courts until one of them has acted. One is the FTC.

Now I am sure this committee is familiar with the report of the American Bar Association Commission on the activities of the FTC as well as the reports of such independent agencies as the group working with Mr. Ralph Nader—a law school classmate of mine of whom I am quite proud, I must add—that the FTC has not yet demonstrated that they are capable of doing this job. There have been signs of resurgent vigor in that commission but they are certainly only incipient. It's quite important and we say we agreed upon this statement unanimously that until some substantial improvement has been shown in the FTC, we believe that "no bill should be enacted which would hamper private access to the courts while leaving consumer grievances to gather dust in the files of this agency." That's our unanimous report on that.

Second, as far as the Justice Department is concerned, I think Senator Hatfield correctly pointed out that the rights of the consumer cannot be left to depend upon the philosophy of a particular administration. In addition, many of us who worked on this report were formerly assistant U.S. attorneys, in Manhattan, for example—I was one of them, Mr. Chairman—and I think we all know that the Justice Department must operate most selectively. It can only bring a limited number of cases in order to make law and establish principles. It's not possible to do an effective job within the agency, with all the vigor that there sometimes is and I think that the U.S. Attorney's Office in the last administration, under Mr. Morgenthau, in which we worked, was one of the most vigorous offices in the country—yet it was impossible to do more than a selective handling of cases.

It does not make sense to permit the particular consumer whose case is involved to be without relief because his case doesn't happen to have been one of those selected for prosecution. An analogy arises from the stockholder field. All of us who practice law know what would happen if only some actions were permitted and corporate officers would have to be concerned only about those cases which could be prosecuted by the SEC. When you are including a deal and the client sees a possible stockholder derivative action—truth comes home. When you're talking about the FTC, as in some kinds of section 5 problems, or Wool Labeling Act problems, so often the client says, "Let's wait and see if they are ever going to do anything." This is a common experience of the bar. That is why we say that there will be an inadequate deterrent if you just sit back and wait for agency action.

Finally, on this question of triggering, Mr. Chairman, I think I can go back to some of the philosophies that underlie our system of justice. I think John Stuart Mill said on liberty, which is still part of our credo, that he made a demonstration that I think has not yet been answered, that with all the good will in the world, public officials just don't look out for individuals the way they tend to look out for themselves. To bar access to the courts is not our system in this country, and law doesn't work the way it should unless you permit individuals to do it for themselves wherever possible.

Now I turn to the question that has been raised about court congestion and the problems of so-called small claims and abuses.

We have considered carefully the argument that has been made. There is no question that the Federal courts are busy. But we conclude that the criticisms may be readily met by some application and analysis of thought. And that upon the application of some rather simple considerations, the criticisms do not appear to us to be meritorious.

In the first place you, yourself, in reading a letter from a respected judge like Judge Solomon of Oregon, have pointed to the availability of rule 23. Opponents of this legislation have admitted that rule 23 is there. I don't think it's been pointed out just how important rule 23 is in controlling the problems that have been mentioned.

First of all, rule 23(a)(4) requires the court to determine adequacy of representation. It's not true to say that any individual who has a small grievance can come in and control the situation for the Nation. The courts will look at the quality of the representation and that is a frequently litigated point.

Second, it's not true to say that every little small claim can come before the court. Under rule 23(b)(3) the court must determine whether there are common questions of law and fact and whether the number of persons affected is great enough to warrant the use of this class action device, and whether this device is the best method to adjudicate the controversy.

The more we think about the availability of rule 23 and what rule 23 does, the less persuasive do these criticisms become. And indeed all the types of problems suggested, about adequate notice and the like, these are routine problems considered by the court in all class actions. Sometimes they use publication when that makes sense. There are ways of allocating cost, administering relief through the use of masters and the like. These are problems considered by the courts in the area of class actions.

In addition, we have proposed in our report an approach which was basically adopted by S. 1378, the bill introduced by Senator Bayh, a twofold change. One is to concentrate on class action relief for restitution, leaving questions of consequential damages for subsequent determination on an individual basis.

And secondly, we would eliminate the requirement of knowledge and intent. In a word, if someone sells me shoddy merchandise or gives me false information about it, whether he intended to defraud me or not, I ought to get my money back. I also shouldn't have to continue to pay installment obligations. That much relief would help enormous numbers of people.

The *Relaxacisor* case, which I think was in California and is cited in our report gives a perfect example of the reasons. Weight reducing equipment which was sold for about \$300 per machine created severe medical problems for the users. Now, the expert testimony produced by the manufacturer showed that he was not in a position to know of the defect. But should the consumers have to lose the money? Should the person selling it be permitted to pocket the funds that he received for the sale of this worthless equipment and walk off with it?

We say that there should not have to be proof of wilfulness, or of knowing. But at the same time the people should only be entitled at this stage to get their money back. If they are going to sue him for consequential damages, then they may have to prove wilfulness in that case.

Now you eliminate most of the bug-aboos about court congestion in this way. First of all, you eliminate from the class action the very time-consuming litigation over consequential damages. How much of my injury was due to the machine?

Second, you eliminate the proof of knowledge and wilfulness which I would suppose constitutes 98 percent of the proof in these cases. You have a device for allocating losses between the seller and the buyer where shoddy merchandise had been sold which is a socially sound measure.

You eliminate the lure of jackpot damages, which is something that has been talked about in connection with nuisance suits. And by this paring of the remedy you can deal with situations like the *Relaxacisor* case. You can establish in a class action, which is the kind of action tailored to this type of problem, the question of liability for restitution, and then in the consequential damages actions, with that much of liability established, you can determine the damages questions on their merits.

Now as to the question of abuses and so-called strike suits which have been referred to frequently, as we have said, the type of remedial solution suggested would tend to take out certain of the lure.

But I also want to read to you a statement which we agreed upon unanimously and this was the position adopted by the lawyers who have been in all types of cases of this sort:

It's hard to see a justification for risking such abuses in stockholders' class actions while denying relief to consumers because such risks exist in consumer class actions. In addition, we acknowledge that such risks inhere in any litigation and may be met in the unscrupulous defense of actions as well as in their prosecution. Thus, for example, corporate defendants have been known to take advantage of their economic strength by subjecting less economically powerful adversaries to extensive motion practice which may be burdensome and costly to manufacturers and their counsel in the hope of discouraging meritorious actions.

As the bar knows, there have been some lawyers who unscrupulously bring actions which are not meritorious, to coerce. But powerful corporate giants also sometimes motion their adversary to death. These issues pose an important problem for the legal profession but the key point, Mr. Chairman is that their resolution should not be pursued at the expense of a particular class of litigants.

Senator Moss. Thank you very much, Mr. Elsen, for your presentation. I am very pleased to have you discuss rule 23. I think you are correct in saying that many of those discussing these class action bills overlook the power that the court has in rule 23 and indeed exercises now on class action matters that are brought in Federal court. And we all, I think, routinely say we believe in the efficacy and effectiveness of the courts. It seems to me we are degrading the courts a little by saying that the courts will be defenseless and will not be able to manage the suits brought and they will overwhelm the courts.

As a practical matter I think they are dealing with it rather effectively.

Mr. ELSÉN. Absolutely.

Senator MOSS. I was glad to have you bring in the analogy of corporate stockholder suits. I don't think it was previously mentioned, yet it's applicable. Class actions are brought by stockholders widely dispersed, obviously, in these big corporate actions. And it would be not only uneconomic but certainly inequitable to require them all individually to bring their little actions against the corporation when they can proceed in one action and be on relatively equal terms as far as litigating is concerned.

And your suggestion about the willfulness requirement being broken down between a simple refund and where damages then are claimed, is a good distinction to make because if, even though the representation was not willful, you are correct, the person certainly shouldn't be compelled to go on paying if he is on a contract payment, nor should he lose his money if he received a product which was not what it represented on its face to be, whether there were any misrepresentations or just the general representation of marketability and usefulness, that is an implied warranty on every sale.

I think you have made a great contribution to the record and I am certainly pleased to have this report of the Bar Association.

(The report follows:)

THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK

Proposed Federal Legislation to Protect
Consumers, Including Consumer Class Actions

By

THE COMMITTEE ON FEDERAL LEGISLATION
THE COMMITTEE ON THE FEDERAL COURTS
THE COMMITTEE ON CONSUMER AFFAIRS
THE COMMITTEE ON TRADE REGULATION

I. INTRODUCTION

Our growing national sensitivity to consumer problems, stimulated by such private groups as "Nader's Raiders" and by such public agencies as New York City's Department of Consumer Affairs, recently led the Second Session of the 91st Congress to consider methods which can assure consumers an effective day in court. The principal bill proposed for this purpose was S. 3201 (introduced by Senator Magnuson), which in its original form had the support of the Administration. By the close of the Session, the bill had been extensively revised by the Senate Commerce Committee and, as so revised, reported out favorably over Administration opposition. The amended bill was then referred to the Senate Judiciary Committee, which failed to issue a report prior to adjournment. The Senate however consequently failed to act on S. 3201 (or several alternative measures introduced by Senator Tydings, S. 1980 and S. 3092) before the end of the Session. Despite this inaction, S. 3201 represents an important Congressional attempt to deal with the issue of consumer remedies and will undoubtedly serve as a starting point for similar efforts in the 92nd Congress. Accordingly, this report will consider the provisions of S. 3201 in some detail in order to set forth what we believe are the basic principles to be followed in drafting fair and effective consumer legislation in the future.

Two devices have been proposed to assure effective representation of the consumer. The first looks to action by administrative agencies. Thus, S. 3201 looks principally to the Federal Trade Commission, which is to be strengthened so as to provide more effective administrative remedies, and to serve as a more effective consumer advocate in the Federal courts. Additional powers are also given to the Attorney General. The second, and probably the more important part of the bill, seeks to devise procedures so that the consumer interests may be vindicated in the Federal courts, primarily through class actions. The necessity for such legislation arises in part from the recent Supreme Court decision in *Snyder v. Harris*, 394 U.S. 332 (1969), holding that

claims may not be aggregated in computing the \$10,000 amount in controversy necessary to invoke the jurisdiction of Federal courts for diversity actions. Under such a holding, class action jurisdiction is lacking for most consumer grievances, which are normally too small to justify the expense of litigation outside of class actions. S. 3201 would make Federal class actions available for such smaller claimants, by using the commerce power and reducing the jurisdictional amount for such actions to \$10, while maintaining the controls that Rule 23 of the Federal Rules of Civil Procedure prescribes for class actions.

FTC relief and consumer class actions in the Federal courts are not, of course, the only available methods to secure appropriate relief. In our discussions, we have also considered the possibility of individual actions through publicly supported neighborhood law offices, public interest law firms or local arbitration. Those with relevant experience in such organizations who have participated in our discussions, however, have advised us that aggrieved consumers appear not to seek out such assistance sufficiently to warrant substantial reliance on those institutions. The most that they are likely to provide is some supplement, but they are not a substitute for meaningful class actions or administrative relief.

On the other hand, the experience of some of us with class actions points to caution in approving the expansion of class action litigation. Stockholders' class actions and derivative suits have proven their value in bringing corporate management to a greater awareness of their fiduciary responsibilities. Nevertheless, they have at times been abused. Some of us are concerned lest class actions for large sums may on occasion be used to harass business firms. There is also reason for concern about Federal court congestion and the difficulties of administering relief for large numbers of consumers. In addition, there is a question as to the propriety of class actions for some types of consumer grievances.

Much of our debate has centered on the optimum method for reconciliation of two possibly conflicting objectives: providing a vehicle for effective Federal class actions which will attract the efforts of able counsel on behalf of consumers without creating unnecessarily increased possibilities for abuse. We are not satisfied that S. 3201 reconciled these objectives in some areas as well as it might have, and accordingly we urge that future bills be revised in the way described below. We also suggest different methods of dealing with the other problems which have been noted. On balance, however, we support the approach of S. 3201 and urge enactment of similar legislation by the 92nd Congress.

II. EXPANSION OF FTC AND ATTORNEY GENERAL POWERS UNDER S. 3201

A. *Description of Provisions*

Title I of S. 3201 is designed to expand the jurisdiction of the Federal Trade Commission and gives the Commission important new weapons in addition to the traditional cease and desist proceedings. First, the Federal

Trade Commission's jurisdiction is expanded by substituting the phrase "affecting commerce" for the phrase "in commerce" in defining acts and practices prohibited under the Federal Trade Commission Act (Section 101). This expansion is intended to reach many local practices which now are not included in the judicial definition of "in commerce." The Commission would also be empowered to obtain preliminary injunctions from the courts to prohibit unfair or deceptive acts under Section 5 of the Federal Trade Commission Act (Section 102). Thus, the Commission may stop such acts quickly rather than waiting until the often long and laborious cease and desist proceedings are exhausted. The Commission is also empowered to bring civil actions to obtain immediate relief on behalf of consumers, including, but not limited to, damages, refund of money or return of property, restitution, reformation or rescission of contracts, repair or replacement of goods and proper servicing (Section 103). In addition, the Commission may seek civil penalties of not more than \$10,000 for each violation. Penalties for violation of cease and desist orders are increased from \$5,000 to \$10,000 for each violation (Section 104).

The Commission is empowered to promulgate trade regulation rules defining unfair or deceptive acts or practices after a hearing. Once promulgated, violation of such rules would constitute an unfair or deceptive act or practice in violation of Section 5(a)¹ of the Federal Trade Commission Act.

Title II of S. 3201, furthermore, specifies fifteen acts or practices which are defined as unfair consumer practices. In addition, the Commission may, by promulgating trade regulation rules under Section 105, create additional unfair or deceptive acts. Section 203 provides for civil and criminal penalties for unfair consumer practices. The bill creates civil penalties of up to \$10,000 for each act and, where the offensive conduct endangers the safety or health of consumers, criminal penalties up to a \$10,000 fine, one year in prison, or both. The District Courts are given jurisdiction of actions brought to enforce any liability created by the Act.

Section 205(a) empowers the Attorney General to institute both civil and criminal proceedings to enforce the provisions of Title II. In civil actions, the Attorney General may petition the court for any relief that may be required to prevent and remedy unfair consumer practices, including, but not limited to, injunctions, damages, refund of money or return of property, restitution, repair or replacement of goods, provision of proper services and reformation or rescission.

B. Discussion

Expansion of Federal powers to protect the consumer, though not sufficient by itself, is desirable and indeed long overdue. S. 3201 appears to be appropriate for this purpose, with the caveat, however, that the Federal Trade Commission in the past has not proved itself sufficiently effective to justify reposing substantial confidence in it as an important guardian of consumer interests. Perhaps this problem will be mitigated by the partial dual jurisdiction which the bill confers on the Attorney General. Such dual jurisdiction, on the other hand, could prove to be a disadvantage if the diffusion of

responsibility should lead to inaction by both agencies. The bill might be strengthened by an allocation of jurisdiction which would divide primary responsibilities more sharply while permitting overlapping activities and perhaps the sharing of manpower and funds for particular projects.

We question the wisdom of relying exclusively on a list of unfair consumer practices, as Title II of S. 3201 would do. Many of us believe that there should also be a general prohibition of unfair consumer practices similar to the prohibitions of Section 5 of the Federal Trade Commission Act. The Commerce Committee justified granting the Commission the power to promulgate trade regulation rules on the theory that as sellers devise new and ingenious schemes to avoid the violation of specifically outlawed practices on the list, new trade rules could outlaw them. Since trade regulation rules would not be retroactive, this would be a cumbersome way to reach new unfair consumer practices. Under a general prohibition the Commission or the Attorney General could act immediately limited only by their ability to convince a court that the new practice was in fact an unfair consumer practice.

We suggest that Section 201(1) be amended to substitute "includes and is not limited to" for "means" after "'unfair consumer practice'" in the language which precedes the list. Thus the list would be retained to provide guidance to the courts as to the practices which, in the past, have been found to fall under the general prohibition, without discouraging judicial innovation when new schemes present themselves.

Many of us do not think that the Commission should be given the power under this bill to promulgate trade regulation rules. Over the last few years there has been a controversy over whether the Commission now has such power. The Commerce Committee report takes the position at page 10 that this section merely makes explicit the implicit authority of the Commission to promulgate such rules. The view that the Commission has no such authority under the present Federal Trade Commission Act is elaborately developed in the supplement to the statement by Gilbert H. Weil before the Senate Committee on the Judiciary, dated August 31, 1970. Some of us do not believe that the Commission has the power to issue trade regulation rules and are opposed to giving it such power through this bill. They do not think that such a grant of power to the F.T.C. should be passed on the tide of consumer protection; the issue requires much more careful consideration on its own merits.

If a general prohibition against unfair consumer practices supplemented the list in Section 201, and Section 105 were deleted from the bill, both the Commission and the Attorney General would still have broad powers to act against consumer frauds. At the same time, consumers, suppliers and the Government would be protected by meaningful judicial review; that is, the courts would determine whether the specific acts and practices before it were in fact unfair consumer practices. Under a trade regulation rule, the court could only determine whether or not the rule had been violated and would not have any meaningful powers of review to determine whether or not the practices barred by a trade regulation rule were in fact unfair consumer practices.

On the other hand, others of us feel that the specific authority granted to the Federal Trade Commission to specify new unfair consumer practices under its rule-making powers is desirable in that it affords the Commission the opportunity to proceed against new practices prospectively in those situations where, because of the uncertainties attendant to the general prohibition, *ex post facto* relief in the courts might be inappropriate. Those who support this view believe that meaningful judicial review is available when the Commission takes its new rule to the courts, because the substantial evidence standard does not preclude the courts from correcting errors of law. We all agree, however, that rule-making power for other areas should not be conferred by this bill.

III. ACTIONS AND CLASS ACTIONS BY CONSUMERS UNDER S. 3201

S. 3201 provides for two types of direct actions which consumers may bring. Under Section 206(a), the "triggering" provision, any consumer may bring a civil action against a supplier, but only if the supplier has been enjoined from committing an unfair consumer practice, either by final judgment or consent decree, in an action brought by the Attorney General or the FTC. This action does not necessarily have to be a class action—the consumer may sue individually. In such a suit, a final judgment or decree in the Governmental action is *prima facie* evidence against the supplier in the consumer action, but a consent decree is not (Section 207). No jurisdictional amount is necessary. Under Section 206(b), a consumer may bring a class action against a supplier without waiting for prior action by the Government, provided his claim is \$10 or more and his claim meets the class action requirements of Rule 23 of the Federal Rules of Civil Procedure. However, before such a suit may be brought, the consumer must notify the Federal Trade Commission.¹ If within ninety days of such notification, either the Federal Trade Commission or the Attorney General publishes in the Federal Register notice of intent to proceed against the unfair practice specified in the motion and in fact does proceed within ninety days, the consumer's action is stayed and consolidated with the Government action.²

The Tydings Bills and most other class action proposals introduced in the 91st Congress do not contain any "triggering provision" requiring governmental action as a pre-condition for bringing the class actions. (E.g., S. 1980 and H.R. 11656.) Bar groups, in endorsing the class action concept, likewise made no reference to the possibility of "triggering provisions" during early discussion of the question.³

EVALUATION OF THE TRIGGERING DEVICE AND OTHER LIMITATIONS OF S. 3201 WHICH RELY ON FTC ACTION

On balance, we disapprove these provisions of S. 3201 insofar as they rely upon the FTC as the principal watchdog of consumer interests. Criticism of the Federal Trade Commission for failure to deal with consumer abuses on a sufficient scale has been voiced by such differing sources as Ralph Nader

and the American Bar Association Commission to study the Federal Trade Commission, appointed at the suggestion of President Nixon. Statistics compiled by the ABA study indicated that from 1961 to 1969 the number of complaints for deceptive practices issued by the Commission declined from an average of 132 in the 1961-63 period to an average of 73 in the 1967-69 period, and the number of cease and desist orders issued for deceptive practices issued by the Commission declined from 180 to 68.⁴ Efforts to revitalize the Commission have been made, but the future effectiveness of the Commission remains to be seen. Until some substantial improvement has been shown in the FTC, we believe that no bill should be enacted which would hamper private access to the courts while leaving consumer grievances to gather dust in the files of this agency.

The "triggering" requirement of Section 206(a) clearly would hamper access to the courts if it stood alone, as the Administration had originally proposed. Section 206(b) seems to permit freer access. Some of us believe, however, that the prospect of possible Government intervention is likely to discourage able private counsel from exerting substantial efforts to bring such suits, since they would be unlikely to receive significant compensation if the suit were eventually directed by a Government agency. Others think that private counsel may not be deterred, and that Government intervention may be useful to consumers, but recognize that the FTC should not be authorized to intervene and thereafter to let such suits stagnate.

For some of us, an alternative might be to permit a class action if one or more public agencies certified that it involved practices of substantial importance to the public, justifying use of the class action device. If the authority to grant such certificates were conferred on more than one agency, a single agency would feel more able to refuse to grant the certificate in appropriate cases without being subject to criticism for shutting off the sole avenue of relief to a class of consumers. Likewise, there would be more protection against the possibility of any one agency being subjected to undue influence to refuse certificates permitting suits against influential defendants. Among the agencies which might be empowered to grant certificates are the FTC, the Department of Justice and local United States Attorneys.

An argument against this procedure is that it may diffuse responsibility, so that it may prove ineffective. In addition, the suggested procedure is rather cumbersome and could even become chaotic.

On balance, we believe that a more reasonable and effective prophylaxis would result from direct controls on potential areas of abuse, rather than from the creation of such preliminary hurdles. The type of controls which we support will be discussed below.

ALTERNATIVE METHODS BY WHICH CONSUMER CLASS ACTIONS MAY BE PERMITTED WHILE AFFORDING MINIMAL OPPORTUNITIES FOR ABUSE

A. The Problems

The President's Consumer Message of 1969 proposed the triggering device as a method of protecting businessmen from harassing actions. Others have

been concerned with the burdens on the Federal courts, which some think to be too congested to undertake additional jurisdiction. Still others have pointed to the difficulties of administering relief for a great many consumers whose damages might differ, depending on the facts relating to their purchases. Critics have also pointed to the problem of using class actions for certain types of suits, such as consumer personal injuries, for which the class action device may not be well suited because of an insufficiently common basis of law and fact.

B. Proposed Solutions

Certain of the above mentioned problems may be disposed of quickly, for they may be manageable. Thus the question of whether, for example, consumers' personal injury class actions may be appropriate tends to disappear so long as the legislation does not limit Rule 23 of the Federal Rules of Civil Procedure, which would serve as a screening device for these as well as other class actions. If S. 3201 does not affect Rule 23, where a District Court finds an inadequate basis of common law and fact in a class action brought for personal injuries, it is likely to rule that the plaintiffs must proceed in individual actions only. Section 206(b), however, seems to grant jurisdiction only to consumer actions as class actions. It should be amended to make clear that a District Court is thus free to be guided by Rule 23 and need not be dismissed if it otherwise meets jurisdictional requisites.⁵

Many of us also think that although there is a problem of court congestion, it should not prevent extension of the class action device to consumer cases. It would appear to be basic that if a remedy is required new litigants should not be barred from the courts because too many others are already there.

To the extent that the Federal courts are crowded⁶ and that the problem is not solvable by such administrative devices as judicial reassignment or increasing the number of judges, consideration might be given to Federal legislation which provides for concurrent relief in state courts, with Federal standards.⁷ Since the purpose is to effectuate national policy and under S. 3201 the suits would be for violation of Federal law, it would seem logical to provide for concurrent Federal jurisdiction—as was done in Section 301 of the Labor Management Relations Act.⁸ Under the Supremacy Clause of the Federal Constitution, state courts are required to enforce Federal law. The power of Congress to create substantive and procedural rights enforceable in state as well as Federal courts has been confirmed by recent cases.⁹ Were this provided for, the number of cases reaching the Federal courts would be reduced.

On the other hand, many state courts, especially those in large urban centers where consumer actions are likely to be brought, are even more crowded than Federal courts. In addition, we have some doubts about the adequacy of state court settlement procedures, based on our experience with stockholder actions. Though considerations would not proscribe the granting of concurrent jurisdiction, the possible availability of state courts may not significantly reduce the needs to provide Federal relief and to make Federal actions manageable.¹⁰

Another possibility which would reduce the number of Federal court consumer class actions, reduce the problem of administering relief and also simplify the problems raised by Rule 23, would be to limit class action relief to the refunding of money paid by consumers and the termination of their executory obligations to make future payments. This would eliminate the necessity for each member of the class to prove his own individual damages in such suits, while leaving it open to him to seek other forms of individual relief after liability has been established. In this way, the class would be rather easily identifiable as persons who had purchased or contracted with the supplier and their measure of damages would be identical. Furthermore, the courts would not have to administer complicated and time-consuming orders for relief. In such cases, the issues would be reduced to whether or not a supplier had committed an unfair consumer practice. Once that decision was made, the supplier would be required to refund all moneys collected. Finally, such class actions would significantly reduce the possibility of nuisance suits. The cases would be simpler and the lure of prospective jackpot damages would be removed.

It should be noted, however, that some of the unfair consumer practices designated in Section 201(1) do not lend themselves to the restitution approach. For example, subsections (A), (B) and (M), and certain of the other subsections, may be violated although no sale of goods actually takes place. If the restitution approach were adopted, provision should be made so that meaningful remedies were still available for violations under these subsections.

If class actions were so limited, the bill would also have to provide that consumers who had suffered consequential damages would be able to seek redress for damages individually, and the prior finding of an unfair consumer practice in the class action should be binding on the supplier. While some of us think that individual damages should be included in the class action, others think that in most cases the vast majority of consumers do not suffer consequential damages. Those who do would be free to seek redress armed with the prior adjudication on liability. In addition, persons suffering severe damages, such as personal injuries, would have no incentive to participate in class actions. Their individual remedies under the developing doctrine of strict liability are much more effective and they would have no trouble in obtaining lawyers on contingent fees.

This suggestion, as noted, would go far toward eliminating the problem of nuisance suits or exorbitant demands for relief by plaintiffs. Having said this, however, we must add that it is hard to see a justification for risking such abuses in stockholders' class actions, while denying relief to consumers because such risks exist in consumer class actions. In addition, we acknowledge that such risks inhere in any litigation and may be met in the unscrupulous defense of actions as well as in their prosecution. Thus, for example, corporate defendants have been known to take advantage of their economic strength by subjecting less economically powerful adversaries to extensive motion practice, which may be burdensome and costly to plaintiffs and their counsel, in the hope of discouraging meritorious actions. These issues pose an important problem for the legal profession, but their resolution should not be pursued at the expense of a particular class of litigants.

ELIMINATION OF THE REQUIREMENT OF
 "KNOWING" DECEPTION IN AFFORDING
 CERTAIN KINDS OF RELIEF

Eleven of the sixteen categories of deception listed in S. 3201 require proof of a "knowing" or intentional falsity before consumers can prevail. Many of us favor elimination of the "knowing" requirement as a prerequisite to the relief of refunds or termination of executory obligations. This should be done, whether or not other forms of relief are permitted in consumer class actions or the suggestion above is adopted that class actions should, under all circumstances, be limited to affording only the relief of refunds and terminating future obligations. We believe that if a supplier commits an unfair consumer practice through ignorance, or even because the state of the art was not sufficiently developed so that he could foresee the result of his action, nevertheless the burden of repayment should rest on the supplier.

The recent case in which the Food and Drug Administration barred the "Relaxacisor" from the market¹¹ illustrates the importance of this amendment. The respondent produced and sold an electrical device which purportedly reduced waistlines by administering a series of electrical shocks to the human body. In reliance on representations that the machine was "safe" for human use, 400,000 purchasers paid \$300 each for the machine. But the court, which prohibited further sales, found that the device could cause, among other things, "abdominal pain and cramps, breathing difficulty, loss of hand control, loss of consciousness, nausea and vomiting, paralysis, red and blistered skin, vaginal hemorrhage, miscarriage" and the spread of dormant cancer cells. Because their individual claims are small, the 400,000 purchasers have no effective way of obtaining refunds or even declaratory relief from making further payments on the installment plan, without a class action. S. 3201 would not help them because they would be required to prove that the company was deliberately or negligently in error in advertising the product as "safe" and the company showed by voluminous proof at trial that it had relied upon its experts, who regarded the machine as safe. These experts turned out to be wrong, but their opinion would probably immunize the company from civil liability. Unless S. 3201 were amended, the traditional right of the consumer to obtain restitution in cases of this sort could not be vindicated. Section 201(1) of the bill should therefore be amended to provide that where restitution and rescission are sought, the terms "knowing," "knowingly" and "intending" do not apply.

This amendment, moreover, would simplify the issues in class actions, where such relief was sought. The issues would then be whether or not the transaction was unfair or deceptive. The good faith or lack of it on the part of the supplier would be irrelevant. Once the practice was declared unfair or deceptive, the relief would also be simple—consumers could get their money back.¹²

In some of the specific provisions defining consumer offenses for which knowledge of the seller may appear to be a part of the definition of the offense, appropriate drafting modifications would be necessary to redefine the violations while leaving intact the remedial policy suggested above.

MISCELLANEOUS COMMENTS AND SUGGESTED
AMENDMENTS TO S. 3201

We have noted above that private actions should not be made to depend on FTC actions. This conclusion is not changed by the prospect that private intervention may be permitted. The report of the Commerce Committee did indicate that intervention is to be desired, but felt it unnecessary to write specific provisions, since the Federal Rules of Civil Procedure are adequate to allow consumer intervention. Private intervention, nevertheless, would seem to be a largely illusory right, since few consumers could afford to retain counsel to pursue individual small claims, and few able attorneys are likely to undertake intervention in a suit controlled by the Government, where a court is unlikely to award sufficient attorneys' fees to justify the necessary expenditure of time to vindicate a small intervenor's rights.

Should Congress enact some form of triggering legislation finally, consideration should be given to permitting a class action to be triggered by other kinds of successful governmental action than those included in the narrowly defined provisions of S. 3201. For example, a number of successful prosecutions for consumer abuses have recently been brought under the mail fraud statute.¹³

IV. OTHER CONSUMER RELIEF IS ALSO NEEDED

The average consumer may not be greatly affected by this legislation, either by the expanded Government powers or by the class action provisions. Other remedies are also indicated, and it would be unfortunate if Congress passed a revised version of S. 3201 and then assumed that no further action was needed to provide consumers with direct relief. Thus Congress may do well to consider legislation giving consumers the same defenses against banks and factoring companies which buy installment contracts and other types of consumer papers as they would have against the seller. As noted in the testimony of Mrs. Virginia Knauer, quoted in the Commerce Committee Report, many consumers are required to maintain payments on shoddy merchandise or face attachments and garnishments of their wages. Allowing the consumer to assert defenses against holders in due course on consumer paper would probably have salutary effect in limiting consumer frauds, since it would require banks and factors to police their customers if they desired to purchase consumer paper of any value.

In addition, the creation of consumer arbitration boards or consumer small claims courts, with a concomitant strengthening of legal services to the poor, would have a direct effect on the lives of consumers. Such boards or courts with limited jurisdictional amounts could grant swift and effective relief to consumers. However, consumers would have to be educated concerning the availability of such bodies and how to use them.

V. CONCLUSION

In summary, we urge the adoption of legislation which will give Federal and state class action relief to consumers. We disapprove those provisions of S. 3201 which make consumer relief dependent on action by the Federal Trade Commission. At the same time, we welcome those provisions of the bill which strengthen the FTC and give added enforcement powers to the Attorney General to protect consumers.

In treating the problems posed by consumer class actions, we advocate solutions directed to those problems rather than such preliminary barriers as requiring "triggering" by a successful FTC action. Thus, one way to reduce the problem of Federal court congestion might be to grant concurrent jurisdiction to state courts. Consideration should also be given to limiting consumer class actions to suits for refunds or the termination of executory obligations, leaving individual consumers to pursue such other remedies as those for consequential damages in separate actions, after liability has been established for them in the class action.

In any event, most of us think that suits for refunds or termination of executory obligations should be allowed without requiring proof that the deception of consumers was done "knowingly." This requirement may have some validity in suits where consequential damages are sought, but should not be required where consumers have been deceived and seek to have their money back.

Thus, on balance we approve S. 3201, with the two important caveats that it requires substantial revision and that its enactment should not be permitted to obscure the need for other forms of consumer protection.

January 8, 1971

Respectfully submitted,

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FOOTNOTES

¹ A majority of the Committee on Trade Regulation believes that the bill should also require notification to the supplier and that a supplier should be able to tender a settlement, with the added proviso that there should be power in the court to refuse to award counsel fees for plaintiffs who have declined such settlement offers and have recovered a lesser amount in the action.

² The bill is unclear whether the Attorney General or the FTC must commence an action within the ninety-day period following notice from a consumer or within ninety days after publication of the notice of intention to bring an action in the Federal Register. We recommend that the bill clearly provide that the Government must bring suit within ninety days from notice to the FTC, since it is unfair to require a consumer to wait longer than three months.

³ Committee on Legal Assistance, "Consumer Protection," 24 THE RECORD of The Association of the Bar of the City of New York 296, 301 (May 1969); Committee on Federal Legislation, New York State Bar Association, Report on the Consumer Protection Class Action Jurisdiction Act, 42 NYSBJ (Jan. 1970).

⁴ Report of ABA Commission to Study the Federal Trade Commission 20 (1969).

⁵ The problem is also to be found in S. 1980, the "Class Action Jurisdiction Act," proposed by Senator Tydings.

⁶ The number of civil cases filed in the Federal courts in fiscal years 1961 and 1969 rose from 58,000 to 77,000, while the backlog of pending cases over the same period rose from 64,000 to 86,000. In 1969, the median time from joinder of issue to trial in pending civil cases reflected delays of 41 months in Philadelphia, 33 months in New York, 28 months in Brooklyn and 27 months in Detroit. Director of the Administrative Office of the United States Courts, 1969 Annual Report, II-18 and Table C 9. It is in these areas of population concentration, particularly New York, where the largest number of consumer class actions can reasonably be anticipated.

⁷ An example of the latter is realistic provision for attorneys' fees. State law provisions do not, as a rule, provide for attorneys' fees in such actions; therefore, the theoretical right of action flounders upon the practical shoal of legal costs. By providing for attorneys' fees, the proposed Federal legislation makes class actions an effective remedy.

⁸ 29 U.S.C. § 185 (1964).

⁹ See *Testa v. Katt*, 330 U.S. 386 (1947); *Hill v. Aro Corp.*, 275 F. Supp. 482 (D. Ohio 1967); *Minkoff v. Scranton Frocks*, 172 F. Supp. 870, 877 (S.D.N.Y. 1959); *Ingraham v. Local 260*, 171 F. Supp. 103, 106 (D. Conn. 1959); cf. *Republic Steel Corp. v. Maddox*, 379 U.S. 650 (1965).

¹⁰ The Special Committee on Consumer Legislation of the Antitrust Section of the American Bar Association, in a Report (455 BNA Antitrust & Trade Reg. Rep. X-1 (Mar. 31, 1970)), proposed that, once the FTC has determined that a supplier has committed an "unfair consumer practice," the Commission itself conduct administrative proceedings before hearing examiners where the violation occurred to accord expeditious relief to consumers adversely affected thereby. While we disapprove of the ABA proposal insofar as it would preclude private actions in the courts, we believe that this procedure, like local arbitration, would be a useful adjunct to private actions if not designed to supplant them.

¹¹ No. 66-1141-WPG-civil, U.S.D.C., C.D. Calif. (April 14, 1970).

¹² If relief in consumer class actions is not to be limited to restitution, then a latent ambiguity between Sections 206(b) and 206(d) should be removed. Section 206(b) provides that consumer class actions should "redress" consumer injury, which includes all proper relief. Section 206(d), however, provides that a successful

consumer may recover, in addition to "damages," his attorney fees. The use of the word "damages" in Section 206(d) should not limit "redress," and this should be made clear.

¹³ 18 U.S.C. § 1341 (1964). E.g., *United States v. Armantrout*, 411 F.2d 60 (2d Cir. 1969); *United States v. Zovluck*, 274 F. Supp. 385 (S.D.N.Y. 1967), *aff'd w/o opinion* (2d Cir. Apr. 7, 1969).

The Study Draft of a new Federal Criminal Code, prepared by the National Commission on Reform of Federal Criminal Laws, provides for the court to direct the prosecution to initiate a proceeding to determine individual rights to restitution in cases of offenses by corporations and partnerships (proposed Code Section 405(1)(b)). However, this would not apply to the individual proprietors, as in the *Zovluck* case, and also is combined with a proposal in the Study Draft to abolish the mail fraud statute completely and replace it by a theft provision (Section 1732) and to impose new restrictive definitions. These changes would severely limit the availability of Federal criminal prosecutions showing consumer fraud and we disapprove them.

Senator Moss. We will hear Mr. Kass and then if there are further questions, I'll direct them to you.

Mr. ELSÉN. Mr. Chairman, I think—I am delighted that the points are so clearly perceived by the Chair. I would like to say—Mr. Kass is going to start on the question of some of the details—I would like to make one additional remark on the question of court congestion also and then turn the presentation over to Mr. Kass.

It's simply, that there are certainly many ways of dealing with courts which are busy, such as assignment of judges, or more judges, but again there is a principle which I would like to state, that is, that if a remedy is required new litigants should not be barred from the courts because too many others are there first.

Now I will turn the microphone over to Mr. Kass.

Senator Moss. Thank you very much.

Mr. KASS. Mr. Chairman, with your permission I would like to address myself primarily to S. 984 and S. 1378 because these are really the only class action bills before the committee. S. 1222, which we have not examined as thoroughly as the other bills, simply provides for governmental action and does not set forth a consumer class action remedy as such. I would therefore like to discuss S. 984 and S. 1378 in light of the principles which Mr. Eslen has articulated and which are set forth in the report which has been introduced into the record.

With regards to the question of concurrent State jurisdiction, we believe it is desirable to provide for such jurisdiction both because this would alleviate whatever Federal court congestion may exist (with or without consumer class actions) and because most States really do not have an effective consumer remedy—whether through class actions or otherwise. In New York, where a great deal of commercial litigation is centered, consumer class actions are specifically prohibited under the case *Hall v. Coburn*. While it would be nice to contemplate a day when all States have class action remedies, it seems to us preferable to have a unified Federal class action remedy, as suggested in your earlier comments, Mr. Chairman.

For this reason, we think that S. 984 should be amended to provide for concurrent State court jurisdiction. S. 1378 already does provide for this and on this point is somewhat preferable.

Incidentally, S. 1378 also provides for Federal incorporation of State consumer laws. We think this is a desirable idea as well. Here the law which is going to be incorporated is basically the Uniform Commercial Code and the UCC, which has been less widely adopted. These are the principal consumer laws, particularly the warranty provisions of the Uniform Commercial Code, and we think the Federal courts would have no difficulty applying them.

Turning to the question of the scope of coverage of the two bills, again S. 984 and S. 1378 take somewhat different approaches. S. 984 continues to rely upon the "laundry list" set forth in former S. 3201 last year in the Senate. Although that list may be expanded through the proposed rulemaking power of the FTC, we prefer the approach set forth in S. 1378, which adopts the association's recommendation that the class action sanction set forth a general principle prohibiting deceptive practices, just as 10(b)(5) prohibits fraud in securities transactions and then provide an illustrative list of some practices

which violate that prohibition. The "laundry list" set forth in S. 1378 is an illustrative list, but not all-encompassing, and we therefore find it preferable. It also sets forth the FTC's rulemaking power to expand this list, but S. 1378 specifies that such rules are only to have prospective effect insofar as consumer class actions are concerned. Again, as you suggested earlier, we think this is a fair accommodation.

The two bills also take somewhat varying approaches to the kinds of remedies made available to consumers. As Mr. Eslen has indicated, our report contemplates remedies which make the consumer whole and prevent him from being injured in the future. In line with this reasoning, S. 1378 sets forth injunctive and declaratory remedies and provides for restitution and actual damages but prohibits personal injury awards of punitive damages. We prefer this because it eliminates many of the difficult questions of proof which Mr. Eslen alluded to and is especially appropriate in light of our recommendation that "knowledge" or "willfulness" be eliminated as a requirement for maintaining class actions. S. 984, however, would have to be amended both to permit these additional remedies and to indicate that personal injury awards and punitive awards are not contemplated, particularly if willfulness is eliminated.

With respect to the issue of "knowing" and "intentional violations," we feel that the Congress' basic concern here is not to limit the class action bill to an overt fraud statute (as Mr. McLaren was suggesting earlier) but to allocate the burden of loss when deceptive or misleading practices are in fact engaged in by suppliers. Who is to bear the burden of those misleading practices? We think it makes much more sense for a court to place the burden on the supplier rather than on the consumer and, therefore, to limit its inquiry to the question of whether or not its practices are in fact misleading.

As the *Relaxacizer* case makes clear, consumers may suffer very considerably if unintentional deception is not a basis for relief. The list of injuries suffered by the consumer, in that case (set forth in page 9 of our report) is startling, and to think that a supplier would be able to escape not only liability for consequential damages but to continue to collect installment payments and refuse all refund requests is shocking, even if he reasonably relied on expert opinion in designing his product.

We have, in fact, crossed this bridge many years ago. The UCC warranty provisions make clear that warranties apply without regard to the seller's intentions, and there seems to be no reason for taking a long step backward by reinstituting a requirement for knowing or intentional violations where consumers sue as a class for restitutions, injunctive relief or actual damages.

For these reasons, we prefer S. 1378 as presently drafted and urge that S. 984 be amended to eliminate the requirement of knowing or intentional violations in the "laundry list" items set forth in that bill. This requirement is eliminated for most of the examples set forth in S. 1378 and the general principle set forth there makes clear that it is misleading or deceptive *practices* with which the courts and the Congress are concerned—and not the intention of the supplier.

Mr. Chairman, I would like to just spend a few minutes discussing the question of alternative types of consumer remedies. Opponents of the proposed legislation often point to alternative approaches as a reason for not going forward with consumer class actions. The kinds of remedies discussed most widely are (1) neighborhood law offices (available to consumers if they are poor, (2) local arbitration panels and tribunals on a neighborhood basis, and (3) amendment of state laws.

In the course of our preparing our report, we have discussed with representatives of neighborhood law offices the question of whether or not they could provide relief for all consumers affected by deceptive trade practices. We have been advised by those representatives that this is not even a possibility in the foreseeable future. Very few consumers come to neighborhood law offices. Those who do seek help can not hope to change ongoing business practices by a supplier committing deceptive acts. Furthermore, many consumers are not even eligible for neighborhood services because they are above the eligibility guidelines. And yet these consumers cannot afford to pay for a private attorney to vindicate their right.

The question of local arbitration tribunals (or decentralized small claims courts) is an interesting one. We think that this approach may have some promise for the future. But we have a number of reservations as to its feasibility as a substitute for class actions. Such tribunals will be expensive, requiring substantial overhead and neighborhood staff. They will have little effect on large retailers and suppliers. And, realistically, they are quite some time off. They are just beginning to be discussed in the largest commercial centers and represent an approach which we can not look forward to on a widespread basis for many years.

The Association is working on proposal for decentralized small claims courts. We think we are among the forerunners of those working in that area. But we view the neighborhood tribunal, not as a substitute for class actions, but as a supplement to handle the many, many individual grievances relating to inadequate repairs, broken furniture and similar problems rather than the larger deceptive practices which affect many, many people in identical ways.

With regret to the third alternative, we do hope that the States will continue to update their consumer protection laws, including consumer class actions and other remedies. We have worked successfully to that end in New York, which has now eliminated the "holder in due course defense in retail installment sales. Other States will, hopefully, follow this lead.

Finally, Mr. Chairman, I would note several minor changes we would suggest in the bills under consideration. S. 1378 sets forth a prelitigation settlement procedure. Such a procedure may be a useful way of avoiding unnecessary suits, but we think it is undesirable unless counsel fees are specifically provided for with respect to the work done by counsel up to the point of settlement. We think the notion of a party's "prevailing" (as set forth in S. 1378) in order to recover counsel fees should be expanded to include the litigation settlements. Otherwise, we think responsible counsel will be unlikely to engage in consumer class actions in the first place.

We also question the \$25,000 recovery requirement set forth in S.

1378. We did not feel in our considerations that this was a necessary or desirable requirement. We also think that the extensive powers set forth in S. 1378 for a district court to decline to accept a class action which it considers trivial should be limited to the requirements of rule 23. As you know, S. 1378 sets forth not only rule 23 but also a series of discretionary criteria to be applied by the court after the rule 23 hurdle has been overcome. This does not seem to us to be desirable.

In one respect we believe that S. 1378 may go too far. The bill specifically incorporates the penalty provisions set forth in applicable State law. Thus, in addition to injunctive and declaratory relief, the court would be authorized to apply State law to impose money penalties arising out of a technical violation of State law. This does not seem consistent with the restitution approach we have taken and we, therefore think that this provision should be reconsidered.

I have not discussed S. 1222 because, as indicated, I do not think it is truly a class action bill. It is a Justice Department bill. But I would note that, even if the FTC or Justice Department does prevail under that bill, what is proposed is a trigger not for class actions but for individual actions. While it is possible they might be class actions, that is not specifically stated. Finally, I note that under that bill a consent decree does not yield any prima facie evidence against the defendant in a subsequent private action. Therefore, we think it is less likely to be helpful for the consumer than might be apparent.

Thank you.

Senator Moss. Well, thank you, Mr. Kass, for your presentation. It was most helpful to us, and you pointed out the parts of S. 1378 which you felt were superior to S. 984, and I have noted those and we will look at them very closely.

I would like to have a little time for colloquy with you but we are pressed by time, so I am going to have to forgo that opportunity.

I appreciate your coming here with Mr. Elsen and presenting your views. Something that has been discussed as thoroughly by a large bar association, such as the bar of the city of New York, and those who work in the courts all the time, is certainly the best kind of testimony we need for this committee. And it will be very helpful to us.

Thank you both very much.

Senator Moss. Mr. John Kelley, attorney for the California Legal Assistance Cooperative Center, San Francisco.

Mr. Kelley, we are glad to have you and we appreciate your proceeding forthwith.

**STATEMENT OF JOHN KELLEY, ATTORNEY, CALIFORNIA RURAL
LEGAL ASSISTANCE, COOPERATIVE LEGAL SERVICES CENTER,
SAN FRANCISCO, CALIF.**

Mr. KELLEY. Mr. Chairman, as my prepared statement shows, I have been litigating class actions in California.

Senator Moss. We will be pleased to put your statement in the record and you may proceed to highlight it as you think desirable for this committee.

Mr. KELLEY. Thank you, Mr. Chairman.

Approximately three and a half years ago, I started law practice in the Modesto office of California Rural Legal Assistance. Within the first few months of my law practice I encountered clients on welfare and farm laborers who were attempting to cut the cost of their food budget by buying from food freezer dealers. Several of these clients explained to me that they purchased the food orders because they were told the orders would last a certain period of time, 7 months, and that the cost of the food order was so cheap that it would pay for the cost of the freezer. Each of these clients had large families. They bought their food orders to cut down food costs.

Each one of these clients stated that within 4 or 5 months their food order was eaten up even though they tried to maintain their regular eating habits. They then realized they were paying \$1,000 for a freezer which a freezer expert said was worth \$200, and that they were still obligated on food order contracts.

After talking to the clients, I wrote letters to the financial institutions and retailers, seeking to void the contracts. After these offers were rejected I sent out investigators to talk to the freezer dealer in the Modesto area. In addition I tried to track down some of the salesmen working for the company. What I learned was that salesmen for the food freezer retailer were trained to memorize a common dialogue—namely that food orders were sold at wholesale. And that the savings would pay for the monthly cost of the freezer.

I then filed a lawsuit with a private attorney in Modesto on behalf of about 200 families. This suit, entitled *Vasquez v. Bay Area Meat*, was a class action to void the food-freezer contracts of residents of Stanislaus and Joaquin Counties. Within a week after we filed the suit, the attorney general of the State of California filed an action against the same retail company and finance company. That suit sought an injunction and a refund of all moneys paid by consumers to this particular food-freezer company and finance company. To date, 3 years later, there has been no refund through the attorney general's lawsuit. In fact the attorney general has not prosecuted the suit because of staffing problems.

After filing *Vasquez v. Bay Area Meat* I was deluged with about 30 or 40 telephone calls in 2 days. Each person said that they too felt they had been defrauded. Many callers had seen private attorneys and were told that the attorney could not afford to handle the case. In fact, I was called by five attorneys in the Modesto area, who stated they felt food-freezer fraud had gone on long enough, but that they simply did not have time to handle such litigation.

Vasquez v. Bay Area Meat, is now before the California Supreme Court on the issue of whether class actions for consumer fraud are proper. Now after the passage of 2 years we are hopeful the California Supreme Court will allow the class action to go forward.

Fortunately in one other food-freezer case, *Suarez v. Mid-State Food*, we have had more immediate success. In *Suarez* the trial court has allowed the consumer fraud class action to go forward. There have been three appellate attacks by the finance companies to try to stop this suit. Each time California appellate courts have rejected these attempts.

Now I would like briefly to describe the procedure followed in class actions, so that you will have an idea of what happens in court in these suits.

Basically, after a suit is filed, there is a necessity to show the judge there is some likelihood that the facts you claim in your complaint in fact are true. The court is not going to allow a class action to go forward in California or in the Federal courts under Federal rule 23 unless you show there is some likelihood that you will prevail. In *Suarez v. Mid-State Food* we deposed the Retail owner. We also inspected the files of the retailer. I had a full-time investigator go through the retailer's customer files. I have attached his affidavit to my prepared statement.

It is a rather incredible affidavit. Out of 705 customers, 105 had written letters of complaint to the retailer. Despite all these complaints the company was continuing in business. I myself have talked to 20-30 customers who never received responses from the retailer. Many of these people tried to obtain representation by private attorneys yet they too were told it was too expensive.

After we submitted all the evidence to the court the judge in *Suarez* decided the class action should go forward. The judge has approved notification of the class members in English and Spanish, of the pendency of the suit. This entire procedure has been approved by the trial court judge.

Senator Moss. Is this in the California State court?

Mr. KELLEY. Yes; it is.

Lest you think from my testimony that only intrastate fraud exists I should emphasize that I have encountered widespread fraud interstate. I have attached to my statement a study of a camera manufacturer, whose salesmen memorized a standard fraudulent sales dialog. I also have had dealings with certain vacuum cleaner salesmen who were trained by the manufacturer to make misrepresentations. These consumer cases in my opinion directly involve interstate commerce and this would come under the provisions of this bill.

I would like to conclude my remarks by summarizing my own general thoughts on class actions.

First, I believe that private consumer litigation is almost impossible unless you allow the consumer class action. In California in 1959 the California Legislature enacted the Retail Installment Sales Act which regulates installment Sales or personal property. For 10 years consumer litigation based on this act was nonexistent. The reason was, that any time an individual had a case he was settled out immediately or he didn't have the money to hire an attorney. This was ironical since the act provided that the prevailing party could obtain attorney fees.

Second, I do not feel that administrative or, public agencies can adequately protect the consumer by their own enforcement powers. My experience in California shows why I feel this way.

You will recall in the first case, *Vasquez v. Bay Area Meat*, that the attorney general of the State of California filed a simultaneous action to try to void those food-freezer contracts. However because of staffing problems the attorney general has taken no further ac-

tion. In fact, the attorney general in *Vasquez* filed an *amicus curiae* brief on behalf of consumers in the California Supreme Court. That brief stated that the attorney general has a limited staff; wishes to help the consumer, but because of the staff limitations it is impossible in most cases. The California attorney general endorsed the concept of private class actions in his *amicus* brief.

Another California experience on administrative inaction is *Daar v. Yellow Cab*. I am not sure if you are familiar with the *Darr* case, which is a classic class action decision by the California Supreme Court. Daar involved overcharging of taxicab users in Los Angeles County. The overcharging amounted to a few cents for each customer but it amounted to millions of dollars over a period of years.

The cab fares were regulated by the Los Angeles County Public Utilities Commission. Despite the overcharging, no suit was filed by either the Public Utility Commission or the California attorney general. The only refund resulted because a private Los Angeles attorney filed a class action which recently, was settled with consumers obtaining a \$1.8 million reduction in fares.

Third, I do not believe class actions in California have been burdensome or frivolous.

Many times I have discussed class actions with private attorneys and friends who represent large corporate clients. All of them agree that class actions in California have not been burdensome or frivolous. Although there has been a significant increase of filings of class actions in California I still have not met any attorney, other than perhaps an attorney opposing me in a lawsuit, who claims that such suits are burdensome or frivolous.

I have no further statements to add at this time, Mr. Chairman.

Senator Moss. Thank you, Mr. Kelley. It is certainly helpful to us to have you come and testify for us and to file this statement which is more definitive. You have one of the, or some of the very few bona fide class actions in litigation in this country for consumers now. There are class actions in other areas as was pointed out, stockholders and otherwise, antitrust, perhaps, but few bona fide consumer class actions, the kind that these bills are directed toward. And I am glad to have your experience on the problem of having a public agency, in this case the attorney general in California, be the triggering mechanism. This is the thing that has hung us up quite a bit in this committee—the insistence of the administration that only after the attorney general has triggered a suit can the class action then be brought. You pointed out that this includes endless delay and that the public law office inevitably is overburdened and has to be selective in the types of cases it can devote its attention to.

The way I talk about it, and it still seems to me the best way to describe it, is to release the great energy and drive of the individual enterprise, who our friends are so anxious to talk about, the free enterprise system. We are sort of talking of the free enterprise of individuals to get into the courts to get relief to which they feel they are entitled. The courts have the procedural mechanism for dealing with the problem so that it will not be unstructured and will not be overburdensome. Ones who do not have a bona fide claim can be at a very early point in the litigation deterred from going further.

The longer I work on this the more convinced I am that we are on the right track. I am sorry that we are very limited in time because your experiences are such that I would enjoy discussing them with you, but—you say that whether or not a class action will apply is now in the California Supreme Court.

Mr. KELLEY. The California Supreme Court in *Daar v. Yellow Cab* held a class action for the individual taxicab users was proper. *Vasquez v. Bay Area Meat*, which is presently waiting decision by the California Supreme Court, will decide whether a class action for fraud against a retailer and finance company is proper. The decision by the court is expected any day. I certainly hope it is favorable.

One other thing I wish to emphasize is the strong deterrent affect of these class actions. It is difficult for me to tell you of all the conversations I have had with reputable dealers in the finance industry. They are afraid that they will lose their share of the finance market if another finance company, without fear of economic loss, buys paper from disreputable retailers. If a competitor buys such retail paper then the reputable company feels they have to go into that business too.

Senator Moss. I appreciate that comment. I have said to many of my friends that I discussed this with, that I do not think that this is a burdensome sort of thing for the legitimate producer and seller of products. In fact, it gives him an equal break with those who do want to use shoddy practices, sales techniques such as you describe, and otherwise take away the market from a legitimate supplier, a person who does honestly produce his goods and sells them under adequate representations.

So it is a protection as much for the honest producer and seller as it is for the consumer. It is not just for the consumer, it is for the fellow that competes in the marketplace in the way we want him to compete. Those ought to be the factors that he sells his products under and not whether he has a fast talking salesman.

Mr. KELLEY. I agree entirely.

You might be interested in reading the affidavit attached to my testimony.

Senator Moss. I am sure I will, Mr. Kelley, and thank you very much.

Mr. KELLEY. Thank you.

(The statement follows:)

STATEMENT OF JOHN P. KELLEY

My name is John P. Kelley, I am an attorney with California Rural Legal Assistance Cooperative Legal Services Center. I worked in the Modesto, California, office of CRLA for three years. From 1968 to 1970, I was the Co-Directing Attorney of the Modesto CRLA office. In my present position with the CRLA Cooperative Legal Services Center I am assisting legal services programs throughout the State of California on consumer and other litigation.

I am the attorney of record in two separate consumer fraud class actions presently pending in California courts. The first case, *Vasquez v. Bay Area Meat*, is a class action where purchasers of food orders and freezers seek to void their food-freezer contracts because of an alleged common pattern of fraud practiced by the retailer. The California trial court in *Vasquez* did not allow the class action for fraud to proceed. The California Supreme Court then granted a hearing. A decision by the Court is expected on this case any

day. The second case, *Suarez v. Mid State Food*, is also a class action for consumer fraud by purchasers of food orders and freezers. In that case a different trial judge has allowed the class action for fraud to proceed.

I have served as a consultant on other class litigation presently pending in California courts. I also, at the request of legislators, offered advice on consumer bills introduced and in fact enacted by the California Legislature.

I am appearing in my personal capacity at the invitation of this committee. Although some judges in California are allowing consumer class actions to proceed, I feel federal legislation is necessary. I fully support the enactment of consumer class action legislation by the United States Congress. My reasons for supporting the enactment of such legislation are based upon both my own personal experience with class actions in California and, in addition, my own general observations on the benefits of class actions to the citizenry of this country.

I. MY INITIAL INVOLVEMENT WITH CLASS ACTIONS

I joined the Modesto office of CRLA in November of 1967. I soon found that our low-income clients, and particularly Mexican American farm workers, came to our office with recurring consumer complaints. The common problem mentioned by many clients concerned the purchase of food orders and freezers from door-to-door retailers.

One client was a Mexican American family with six children. The husband was partially disabled from field work because of a heart attack. That family requested my assistance in dealing with a food-freezer retailer located over 70 miles from Modesto. The financial institution which called my client at home, at school, and at her parents' residence was located over 60 miles from Modesto. This family complained that the company salesman told them they would save money by buying a food order and a freezer. The 7 month food order cost roughly \$300, and the freezer cost \$1,089.

I initially tried to resolve this case by letters to the retailer and the finance company requesting rescission. This proved to be fruitless so I then referred the clients to private attorneys to see if they would provide assistance in a such for punitive damages. My client saw three different attorneys. Each one said he could not economically handle the case because of the small amount of money involved and the cost of litigation.

Several other Mexican American families were referred to our office by their social workers. They, too, complained about the food-freezer dealer. They stated they signed a food-freezer contract because the salesman told them the savings each month from buying a "7 month" food order would pay for the cost of a freezer. These families also stated that the food order did not last for seven months and that they felt they had been cheated.

Almost simultaneously a private attorney in Modesto called our office. He, too, has several individuals who claimed they had been cheated by the same food freezer company. In addition, the attorney told me that a former salesman of the food-freezer company claimed that he was trained to memorize a standard sales dialogue. The salesman stated he subsequently learned this dialogue was fraudulent.

The private attorney and I, by letter, attempted to settle the claims of our clients. Finally, when no agreement was reached we filed a class action on behalf of residents of Stanislaus and San Joaquin Counties to void the food-freezer contracts on the grounds that they were obtained by a common pattern of fraud. Within a week after the filing of our case the California Attorney General also sued the same food-freezer dealer and finance company. The Attorney General's action sought to enjoin the retailer from continuing to engage in a pattern of fraud and to cancel the food-freezer contracts.

Local newspapers in Stanislaus and San Joaquin Counties then briefly described these two suits in their news sections.

Immediately, the Modesto office of CRLA received calls from over 30 different people who stated they, too, had been cheated. One case I particularly remember concerned a Mexican American woman. She became so sick after learning of the terms of her food and freezer contracts that she had seen her local doctor for medication. Another woman felt so helpless after signing the contracts and feeling that she was cheated that she saw a private attorney. He advised that she place an ad in the local newspaper since individually the case was too expensive to litigate.

Numerous private attorneys in Stanislaus County who opposed the Modesto office of CRLA personally called me and referred other customers of the retailer to the CRLA office. Each attorney stated to me that he was happy such a suit was filed because fraudulent consumer practices had continued for much too long in Stanislaus County. One attorney, who incidentally is a justice court judge, considered putting his client through bankruptcy rather than go through the extensive cost of litigating with the retailer. Another attorney described a client who was illegally sued 70 miles from his residence in the small claims court by the food-freezer dealer.

From the date of the filing of the *Vasquez* case, the retailer and particular financial institutions attempted a quick settlement by compromising the claims of our *individual clients* but not the claims of other absent class members. Initially, the trial court approved a settlement which relied on the Attorney General's lawsuit. That settlement collapsed when the retailer went bankrupt and the Attorney General's suit remained dormant.

Today, almost two years later, the food-freezer company is bankrupt. The Attorney General has not proceeded with his suit to obtain a refund. Thus, the only remedy for the 100-200 consumers in Stanislaus and San Joaquin Counties is our class suit. Even that remedy has been difficult to obtain since the trial judge assigned to the case ruled a class action for fraud was not proper.

A second consumer class action which I am presently litigating is *Suarez v. Mid State Food*. There, a different food-freezer dealer obtained contracts from other farm worker families. On behalf of 10 families I wrote the retailer and financial institution requesting a refund of money paid for the freezer. The finance company, which financed over \$65,000 of food-freezer contracts, responded by suing the food-freezer dealer on the grounds the contracts were fraudulently obtained. Despite initiating such a suit, which to my knowledge is one of the few of its kind anywhere in the United States, the financial company continued to press consumers for payment in full on the contracts.

To protect our clients and other consumers, we intervened in the suit. We alleged that the finance company had full knowledge of the retailer's fraud and that purchasers of the food-freezer orders were entitled to a refund on all freezer payments.

In contrast to *Vasquez v. Bay Area Meat*, a different trial court judge has ruled that our class action for fraud is proper. *Suarez v. Mid State Food* is now proceeding as a class action. A plan of notification has been approved by the trial court. We have deposed the owner of the food-freezer company and the vice-president of the finance company. We also have inspected the files of the retailer. Three attempts by the financial institution to stop the suit proceeding further as a class action have been rejected by the California Appellate Courts, including two denials for a hearing by the California Supreme Court.

Some of the facts which are part of the court file in *Suarez v. Mid State Food* may be of interest to this committee. The former owner of the business has testified under oath that the retail salesmen were trained a common dialogue (which, in our opinion, was fraudulent). Inspection of the company files shows that out of 705 customers, 104, I repeat, 104, wrote letters of complaint to the retailer. The turn-over in salesmen by the retail institution also is revealing. During the period of two years the company employed 46 separate salesmen, 19 of whom lasted only one month; nine of whom lasted only two months. With few exceptions these salesmen were transient and attempts to locate them have been extremely difficult. I attach to this testimony an affidavit by a CRLA investigator who inspected the retailer's files.

Additional affidavits submitted to the trial court in *Suarez* include statements from two finance industry executives. They state it is common knowledge in the finance industry that food-freezer dealers usually are disreputable. Attached to this testimony is one of the affidavits. (However I have deleted his name so he will not be harassed.) He states:

"The last time I ever authorized purchase of papers from a food dealer was 22 years ago when our company purchased ten food and freezer contracts from a dealer. After purchasing these contracts I found that the majority of the obligated parties had been told misrepresentations by the salesmen of the dealers and that the freezers they were purchasing were sold for two times their retail value. My years of experience in the finance industry have convinced me

that a finance company, in fact, is a guiding force over retail dealers. Retail dealers frequently are not abreast of the law and do not know of changes enacted by legislatures. Furthermore, some dealers will attempt to over-sell their products and the individual consumers will not have the sound judgment to resist a hard-sell."

II. OTHER EXAMPLES OF CONSUMER FRAUD

Several years ago a client came to the CRLA Salinas office. A door-to-door retailer was selling cameras for \$435 which had a reasonable commercial value of approximately \$100. A summer student enrolled at Harvard, participated in the sales training program of the retailer. I attach the student's description of the training procedure to this testimony. A lawsuit filed by our Salinas office to void our client's camera contract was quickly settled by the company. The other consumers, needless to say, received no assistance.

Perhaps the committee might assume by these examples that my experience in the consumer fraud area concerns only local situations in the State of California. I must emphatically state that this is not true.

I am certain there is wide-spread inter-state fraud in the consumer field. One example of inter-state fraud concerns a vacuum manufacturer located out of the State of California which franchises dealers in California. Sales manuals and training materials are supplied by the manufacturer. A former salesman has provided me with a copy of the sales manual. It contains misrepresentations as to the sponsorship of the product and outlandish claims as to its effectiveness in improving a family's health. In fact, one federal agency sued the vacuum company in federal court in California to enjoin some of the misrepresentations. No refund was obtained for the consumer.

An additional case which I have studied concerns an out-of-state sales corporation which comes into California and settles in given locales for a few months. The company engages in a massive telephone campaign telling consumers that the corporation is surveying consumer responses as part of a nationwide marketing study. The lucky consumer is invited to an office to see the new products. Since I was individually called at my home by a salesman from that company, I sat in on a sales session. I was told by the salesman that my house needed fire alarms costing \$300-400, or a sewing machine for \$400-500. Weeks later the company left Modesto after quickly saturating the market.

This particular company was sued by the District Attorney of Sacramento County. An injunction issued prohibiting the company from continuing its practices in California. Refunds were obtained for individuals in Sacramento County who complained to the District Attorney's Office. However, the Deputy District Attorney candidly admits that refunds probably could have been obtained for all California consumers, but because of staffing problems he could not litigate the case further.

III. THE NECESSITY FOR CLASS ACTIONS

A. Encourage Private Representation of Consumers

I believe that if class actions are not permitted in state and federal courts, private representation of the consumer will be almost non-existent. I base this belief on the experience in California—a state which has very laudatory consumer protection laws.

In 1959, the California Legislature enacted the Retail Installment Sales Act, commonly known as the Unruh Act. That Act regulated retail installment sales of personal property other than automobiles. *It expressly provided that the prevailing party in litigation brought under the Act was entitled to attorneys' fees.*

Despite that section, private attorneys in California have never sued under the provisions of the Unruh Act. Indeed, for a period of eight years not one case involving fundamental interpretation of the Unruh Act was decided in California by either the Courts of Appeals or the Supreme Court. Now, 13 years later, there has been only one California Supreme Court case interpreting the Unruh Act, namely *Morgan v. Reasor Corp.*, 73 Cal.Rptr. 398, 69 Cal.2d 881 (1968). The *Morgan* case itself involved a substantial amount of money namely an \$11,000 note secured by deed of trust, so it was not a typical consumer transaction. All other cases involving interpretation of the Unruh Act concern litigation involving commercial interests and not the consumer.

The reason why consumer litigation under the Unruh Act has not reached any appellate level is simple. In any individual case a retailer or financial institution will quickly settle the case rather than allow the case to go up on appeal to an Appellate Court in California. I know of my own personal experience the tremendous attempts by the financial community in California to avoid a ruling on whether a class action for consumer fraud is proper.

Unfortunately, the reputable business community does not realize that absent a class action, disreputable businesses will flourish. Put simply, the unethical businessman can quickly settle out any individual consumer who proves troublesome. Then the business continues its practices on other consumers who do not have the sophistication to either consult an attorney or to speak up when they feel they have been wronged.

B. Public Agencies Have Limited Resources To Protect Consumers

I do not believe that consumers should be forced solely to rely on public agencies to protect this interest by obtaining injunctions and/or seeking total restitution. I support aggressive law enforcement by the Federal Trade Commission, the United States Department of Justice and State Attorney Generals. Nevertheless, I disagree with last year's testimony by Professor Milton Handler that consumer class actions should not be allowed because the most effective remedy should be to stop consumer abuse at its source and to create new nation-wide consumer small claims courts.

My experience in food-freezer class action litigation is an example of why I feel this way. For years public agencies in this country have known that many door-to-door food-freezer dealers defraud the general public. *Consumer Reports* frequently has reported activity by the Federal Trade Commission and the California Attorney General seeking to stop fraudulent activity by many food-freezer dealers. (See *Consumer Reports*, November, 1958, September, 1963, and November, 1969.) Despite such activity, it is obvious, at least in California, that actions by public agencies have not remedied this problem.

My own experience in *Vasquez v. Bay Area Meat* further illustrates why sole reliance on suits by public agencies will not provide sufficient consumer protection. As earlier stated, the California Attorney General sought to enjoin further practices by the food-freezer dealer in California and to obtain a refund of all monies paid by the consumer. However, since the filing of that suit, May 8, 1969, the Attorney General has taken no further action in the case. There has been no attempt to obtain any refund of monies paid by consumers to the retailer or finance company.

The reason why the Attorney General took no further action is simple—he simply does not have the staff to try many consumer cases. Indeed, the California Attorney General commendably filed an *amicus curiae* with the Supreme Court on behalf of consumers in *Vasquez v. Bay Area Meat*. The brief stated:

"However, the Office of the California Attorney General, and the Consumer Fraud Unit in particular, like any other governmental agency, is faced with basic budgetary limitations and alternative demands on available manpower. The number of deputies and investigators assigned to the Consumer Fraud Unit throughout the State of California is smaller than the average small firm engaged in the representation of the seller of the goods. This year, for the first time in the history of the Consumer Fraud Unit, it has become necessary to respond to many of the 10,000 consumer complaints received each year with a prepared form letter . . ."

"Under such circumstances, it is the belief of the State of California that competent, diligent and aggressive prosecution of representative class actions is a necessary and meaningful method of affording protection to the consumer. Such suits allow individuals of low or medium income access to the courts when they might otherwise not be able to afford representation." P.5, *Amicus Curiae Brief of the California Attorney General, Vasquez v. Superior Court*, California Supreme Court Case No. SAC 7860

C. Class Actions Are An Effective Deterrent On Illegal Business Activity

I believe that the mere threat of class actions is an extremely effective deterrent on business conduct which is unlawful but profitable, if it cannot be challenged. I have had extensive discussions with retailers, finance industry executives and attorneys employed by corporate firms in California and Illinois. In private conversations these individuals candidly state that they feel the class action is a most effective way of deterring illegal business activity.

This is particularly true in the retail installment sales finance area where finance institutions attempt to maintain their share of the finance market. The reputable finance company is afraid that it will lose its share of the market if other finance companies do business with disreputable retailers without the fear of a significant economic loss.

This fact is one main reason why I continue to concentrate my efforts in the consumer class action area. Frankly, words do not adequately express the encouragement given to me by members of the business community to continue in the class action field.

Some have argued in hearings before this committee last year that the deterrent effect is too strong because consumer class actions may hurt reputable businesses. Unfortunately, even reputable businesses at times violate consumer laws. At CRLA we sued a large reputable retailer for suing consumers hundreds of miles from their homes. This class suit was successfully settled. So, although most large scale consumer abuse does not involve reputable dealers, upon occasion, even they will engage in illegal conduct which can only be effectively deterred if the possibility of a massive consumer class action exists.

IV. ARE CLASS ACTIONS SO BURDENSOME THAT CONGRESS SHOULD NOT ENACT A CLASS ACTION LAW?

A. Have The Courts in California Been Burdened By Class Actions?

I believe that California Courts have *not* been burdened by the filing of class actions in this state. In 1967, the California Supreme Court in *Daar v. Yellow Cab* ruled that a class action seeking a refund for all over-charged taxicab users in Los Angeles County was proper. Since that decision the private bar and legal services attorneys have filed additional class actions. Nevertheless, no one has claimed that there has been any abuse of this procedure in California.

I have appeared before four different judges in one of my class action suits, argued a class action before the California Supreme Court, and have talked with at least 20 or more private attorneys in California who are either prosecuting or defending class actions. No one, with the exception of attorneys who are on the other side of cases I am engaged in, has claimed that these suits are burdensome. I believe that recent rulings by California trial judges allowing class actions to proceed in California show that California judges now realize that a class action is a most useful way to resolve many disputes at once.

B. Has There Been A Problem Of Frivolous Class Actions in California?

My answer is most emphatically "no." I have talked with attorneys working for corporate firms in California and law school classmates who work for corporate firms defending class actions. Not one of these attorneys has complained to me that the class action suits filed in California are frivolous. My own experience is that the only people who complain that class actions are frivolous are attorneys who make such claims in oral argument before a court or individuals on retainer by large commercial interests.

If any problem does arise in the class action area concerning supposed "frivolous litigation", it can well be handled by the use of preliminary hearing analogous to the hearings required by Federal Rule 23(b) (3) class action. A preliminary hearing was held in *Suarez v. Mid State Food*, where we submitted evidence to the trial court showing that class treatment of the suit was appropriate.

C. Are There Problems With Attorneys' Fees?

Last year, in hearings before this committee and the Senate Judiciary Committee, several individuals complained about the size of the attorneys' fees of \$250,000 in the *Playboy* case in Los Angeles. The facts of that case were never fully discussed in any of the Senate hearings. The truth is that Judge Bernard Selber, an extremely competent Superior Court Judge in Los Angeles County, held extensive hearings on the settlement of the *Playboy* case. Prior to the hearings, all individuals throughout the country were notified of the proposed settlement and the court opened a special post office box to receive any possible complaints from consumers. After many days of testimony the court concluded there was a 50-50 chance of the plaintiffs prevailing in the case and that the settlement in his opinion was imminently fair to all parties.

A more recent example of California Judges regulating attorneys' fees was the settlement of *Daar v. Yellow Cab*. That case was settled by giving future taxicab riders credit of \$1,400,000. When the settlement was presented to the trial court in Los Angeles the court lowered the attorneys' fees from \$450,000 to \$200,000, payable over a period of 7½ to 8 years.

My belief is that California Judges carefully scrutinize any settlement of class actions including provisions for attorneys' fees.

D. Should A Triggering Device Be Required?

I am opposed to a triggering device which precludes consumers from filing a class action until an administrative agency certifies that suit is proper. In *Daar v. Yellow Cab*, the Public Utilities Commission of Los Angeles County took no action on behalf of the consumers to obtain a refund of over-charges. In *Vasquez v. Karp*, the Attorney General of the State of California, because of staffing problems, simply has not proceeded with his suit. Recently, I discussed this issue with perhaps the most aggressive District Attorney Consumer Fraud Unit in the State of California. I was told by the Deputy District Attorney that he opposed any triggering device, and that the consumers should have their right to file a private class action if they so wish.

I have serious doubts that even a 90 day notice to the Federal Trade Commission is advisable. I know of businesses which have destroyed business records prior to the filing of a lawsuit.

CONCLUSION

In concluding I would like to emphasize to the committee my belief that discussion of class action bills in Congress has been clouded by emotionalism. I personally believe that of all areas—whether it be stockholder fraud, shareholders' derivative suits, or Anti-trust actions—the consumer area is the most appropriate area where a class action should be allowed. It seems ironical that massive business Anti-trust suits, stockholder derivative actions and stockholder fraud suits are allowed as class actions, yet at the same time the most logical group suitable for class actions, consumers, have so far not been allowed their day in court in most jurisdictions.

Thank you.

Enclosure:

I, the undersigned, declare:

I am a community worker and investigator for the office of California Rural Legal Assistance.

I, my wife, Jean Dindia, and Earle Reneaux, another employee of the Modesto Office of California Rural Legal Assistance, have inspected and made copies of the files of Midstate Food Service which were turned over to us by Mr. Howard Verhoef. We made copies of the front page of each file, which shows the name and address of the customer, the types of orders they bought, the salesmen who sold the orders and the finance company which purchased the food and freezer contracts. I have attached to this declaration a copy of the front page of the file of Louis Wilson. In addition, we inspected the contents of each file and if letters of complaint were contained in the file, we made copies of the letters.

I have made a computation of the letters of complaint: From March of 1967 to March of 1969 Midstate had 705 separate files. Upon inspection of the files, we found 104 written complaints to Midstate Food. Many of these complaints were because of misrepresentation as to the quality of Midstate food and especially, the cost of the food; other complaints were over the failure of Midstate to mail out monthly special food lists to customers. Another common complaint was frustration by the customers at not being answered after many telephone calls and letters to Midstate. I have selected just a few of the complaints contained in the Midstate files and copies of these letters of complaint are attached to this declaration.

Both my wife and I became more knowledgeable when we found out that a large number of people were paying two times the retail price for a freezer. (My wife and I, after reading these files, decided to price the cost of retail freezers. We found them one-half or one-third of what Midstate customers paid for them.) Reading the letters of complaint, I was especially struck by

the helplessness of people who attempted to get redress when Midstate ignored their complaints and the finance company just kept on demanding payments.

I made a tabulation on the salesmen who sold for Midstate Food, as reflected on the front page of each file. During the time from March 1967 to March of 1969 there were 46 different salesmen, the majority of them employed a very short duration. Nineteen of the salesmen had a record of sales for only 1 month. Nine more had a record for only 2 months. It gave me the impression of a fly-by-night outfit. Only 15 of the salesmen had no written complaints in their files and all but one of these salesmen who did not have written complaints lasted only 1 month with Midstate. Eight of the salesmen had five or more written complaints; three other salesmen had two or more written complaints, totaling 60 written complaints. The rest of the 54 complaints were unevenly divided among the other 23 salesmen. This means that there was one written complaint for every seven contracts.

From the files it appears that Avco Thrift came into the picture late in 1968. By that time, 94 complaints had already been written out of 540 files of customers, meaning that one out of six customers had complained. This fact could have easily been discovered by a finance company which gives its support to reputable businesses.

I declare under the penalty of perjury that the foregoing is true and correct. Executed at Modesto, Calif. this 19th day of March, 1970.

PHILIP DINDIA, *Declarant.*

In The Superior Court of the State of California In and For The County of—

———, A CORPORATION, PLAINTIFF

No. ———

vs.

———, ET AL., DEFENDANTS

and

——— ET AL., INTERVENORS

DECLARATION OF ———

I, the undersigned, declare:

My name is ———. I am President of the ——— Finance Corporation located in ———, California. Since 1939 I have been employed in various positions in the finance business. In 1951 I founded ——— Finance Corporation and I have been President since that time.

I am on the Executive Committee and Board of Directors of the California Loan and Finance Association. This Association represents in excess of seventeen hundred (1700) finance company licensees in the State of California. One of the purposes of this organization is to protect the consumers who obtain financing from licensees throughout the State of California. Since 1954 I have been on the Board of Directors of this Association, and in ——— and ——— I was President of the California Loan and Finance Association.

I am also on the Board of Directors of the California Independent Licensees Association, an organization consisting of smaller independent finance companies licensed in the State of California.

Finance Corporation is licensed under the State of California Personal Property Brokers act. Our Company buys retail installment sales contracts from dealers. Our business is substantially similar to the business of ——— Thrift, except that we do not take deposits since this is not permitted under the Personal Property Brokers act.

The general industry practice followed before a dealer's paper is purchased is to ask a dealer for a detailed financial statement. After obtaining this detailed financial statement, a finance company will obtain a credit rating on the dealer. If a dealer shows that his business has had a loss in the previous year, his credit rating and business will be very thoroughly checked out.

A second factor considered by a finance company is a determination of the reputability of the dealer which is seeking an agreement with the finance company. One of the important factors is an analysis of the price that the dealer

is charging for his merchandise. If a dealer sells his products for an unreasonable price, most finance companies will not purchase that dealer's papers. This results because of two reasons. First, a finance company knows that if a contract is sold for an unreasonable amount, the finance company will frequently suffer a loss on the payments because the consumer will default. Secondly, a dealer has a responsibility to protect an individual consumer, since a finance company in purchasing paper from a dealer in effect becomes an immediate party to the action, even though the finance company did not individually sell the product. As a finance company, we are more able to make an objective judgment as to the reasonableness of a transaction and we feel we owe this protection to the consumer.

Finance Corporation, and the finance industry in general, does not purchase retail installment sales contracts from food dealers because it is common industry knowledge that the freezers sold by said companies are usually sold at a price two times their regular retail worth, and the food sold by said companies is fully consumed by customers before the period guaranteed by the dealer. The last time I ever authorized purchase of paper from a food dealer was 22 years ago when our company purchased ten food and freezer contracts from a dealer. After purchasing these contracts I found that the majority of the obligated parties had been told misrepresentations by salesmen of the dealers and that the freezers they were purchasing were sold for two times their retail value. I, therefore, ——— discontinued purchasing from that dealer and since that time ——— Finance Corporation has never purchased from any food company.

My years of experience in the finance industry have convinced me that a finance company, in fact, is a guiding factor over retail dealers. Retail dealers frequently are not abreast of the law and do not know of changes enacted by legislatures. Furthermore, some dealers will attempt to oversell their products and the individual consumers will not have the sound judgment to resist a hard sell. At ——— Finance Corporation we are very careful in screening out the dealers that we will purchase paper from. However, even after our company has made a decision to purchase paper from a dealer, we then will ask each individual customer of the dealer detailed questions to determine if they understand the obligation they are entering into. We believe that it is both sound business judgment and also a matter of responsibility to the consumer that paper not be purchased from companies which engage in the hard sell and which prey upon consumers. In fact, this philosophy is enunciated in the

preamble of the California Loan and Finance Association.

I declare under penalty of perjury that the foregoing is true and correct.

EXECUTED at ———, California, on the ——— day of February, 1970.

INTRODUCTION TO THE COMPANY

——— Corporation is Big Business incarnate. They are a multi-million dollar corporation, and they are listed on the New York Stock Exchange. They claim as their subsidiaries ——— Design, ———, and ——— Co. Their most important activity is photo instrumentation work for the government. They have enjoyed a distinguished twenty year career in this field, but in the last few years they have been trying to carve a niche for themselves in the consumer market. The fruit of this effort is the ——— camera.¹

The first task of the staff trainer, ———, is to convince the new men that the ——— is a worthwhile product. ———'s presentation of this automatic, electronic camera was impressive, but a few loopholes were evident even on the first day. The camera is sold to the consumer for over \$400, but a salesman can get one for \$90. Also ——— answered no when asked if he ever sold the camera to his friends. He said he did not want complaints to come back to him, but why should he have qualms when the company guarantees the performance of the camera for 2 years?

To dwell on these discrepancies misses the main point of the first lesson for the salesman trainee at ———. The Company operates on the valid selling

¹The Company often claims in its current sales campaign that this automatic, electronic camera is "——— first brush with the public." This is untrue because the camera now being sold is the ———. It is the third model of a camera that first appeared on the market three or four years ago.

principle that people buy what they want, not what they need. Therefore, you sell people the story behind the product rather than the product. This is the guiding dictum in the ——— division of Corporation, and it clears the way for a very aggressive and exploitative sales approach.²

The ——— Story

The drama of the fantastic ——— opens on the first page of the sales presentation book.³ Although use often varies with experience, new salesmen are taught to read the pitch from this book. The first phase of the sales presentation is the introduction and the legitimation of the Company. After reading the first page to the customer, the salesman flips out the brochure⁴ describing the history and organization of ——— Corporation. ——— achievements in space and defense work are impressive. The salesman only has to touch on the highlights of the Company's career before the customer is quite willing to accept ——— as an established and highly professional outfit. Of course, the Company never misses an opportunity to let a potential customer draw the disarmingly obvious conclusion that, if it's good enough for the government, it must be good enough for me.

The camera demonstration is the next thread to be wound into the plot of our story. The demonstration is seductive because the camera is simple to operate and people enjoy tinkering with a durable, tangible object. I should mention that a salesman is taught to make the transition between Page 8 and 9 ("You thought it was going to be heavy, didn't you?") by pressing down on the top of the camera with his thumb as he hands it to a member of the family. When he slides his thumb off the top of the camera, it suddenly feels lighter to the person.

In the next phase of the presentation, the customer is confronted with a veritable onslaught of merchandise. ——— is not selling a camera, but "a photographic program" that includes a carrying case, three photo albums, three packs of film, and \$700.00 worth of discount stamps. This last item is the most blatant indicator why the Company wants to offer its camera in a package deal. I would say the stamps are more or less worthless,⁵ but they are very effective as inflators of the value of the photographic program. The potential customer has a very difficult time judging the value of the camera itself because the salesman asks him to take a guess at the price of the entire photographic program while chanting \$19.95 carrying case, three \$9.95 photo albums, \$11.98 worth of film and, most important, \$700.00 worth of discount stamps.

Before closing in for the sale, the salesman must acquaint the customer with the Company's rather demanding referral scheme.⁶ The salesman is advised not to sell the camera unless a person is willing to allow his name to be used for an endorsement, demonstrate the camera to five friends, and inform the Company of their names, and give the salesman the names of four people to whom he can demonstrate the camera. These four names are to be filled in on the back of the owner's registration card.⁷ Also, the salesman is supposed to get the customer to sign referral letters⁸ that can be presented to these people when the salesman calls on them.

² Normal working hours for a ——— salesman are 2:30 p.m. to 10:30 p.m. weekdays and 9:00 a.m. to 10:00 p.m. on Saturday and Sunday. The Company prefers these late hours because they want both husband and wife to be home when the sales pitch is given. At \$491.00 a shot, it is important to have both decisionmakers in the family at the time of sale.

³ ———, the staff trainer, told us in our first day of instruction that this book had been approved by the FTC and the BBB. Mr. ——— of the FTC and Mr. ——— of the BBB say their agencies do not approve or certify such books and neither had seen the ——— book.

⁴ I have included a xerox copy of this brochure.

⁵ I say the stamps are worthless because I think they are a guise for the Company's film processing profit margin. We can assume that the overwhelming majority of ——— owners use the stamps because the camera is only supposed to be sold door-to-door in package form. Also, we know that all ——— film must be processed at the ——— plant. It seems to me very likely that ——— must be able to process film profitably at \$3.98 per pack. The retail price of \$4.98 is intentionally inflated to lend credibility to the salesman's claim that the stamps represent a dollar saving on every pack of film.

⁶ The tantalizing introduction to this scheme ("Provided you can do three important things for us, we have a wonderful surprise for you!!!"), seems to me a misrepresentation because the only surprise is that you get a chance to buy a camera.

⁷ I have included a Xerox copy of the owner's registration card.

⁸ I have included a Xerox copy of the referral letter.

The referral system is abused for several reasons. The most important reason is that a salesman gets a \$100.00 commission rather than the usual \$60.00 commission for selling a camera to a referral lead. This kind of incentive inspires people like — to type up his own referral letters whenever he chances across a "cold turkey" sales.⁹ Also, you should note that, if one of the four referrals does not let the salesman demonstrate the camera, the customer must come up with another name for the salesman. Because there is no mention of the referral system in the contract, I assume that this is an illegal imposition on the purchaser of the camera.

The finale in the — act is known in the trade as the close. The punch line to the salesman's alleged advertising inquiry comes on Page 30: "Fine, within 10 to 12 days, we will deliver the entire Photographic Program into your home." The salesman probably has not asked the person if he wanted to buy the camera, but he wants him to begin assuming mental possession.

The price is the most delicate phase of the operation. However, the total cash price is painlessly worded as only \$41.50 per year $\times$ 10 years (P. 30). In the indisputable words of Mr. —: "Anybody can afford \$41.50 per year." If you turn on to Page 31, you will see that the prices are more clearly stated, but salesmen are instructed to cover this page with the contract, the credit application and an advertising foldout. — explained that the law requires us to include this page in the book, but to show it to a customer would only confuse him.

Rather than turn that last page, the salesman shifts the action to the credit application.¹⁰ Here you try to convince the customer that he is somehow competing to qualify for the — program. The Company does its own financing, and a call to the Credit Bureau and a department store constitutes a credit check. The check is made the morning after the order is turned in because salesmen are paid their commissions on a daily basis.

After the credit application comes what is known as the conversion. The salesman has thrown around the figure \$41.50 per year in reference to a ten-year payment plan. Of course, neither the Company or the customer wants to keep track of payments for that period of time. The conversion is simply getting the person to sign a 30-month contract instead of a 10-year one.

As a "button-up"¹¹ and a lure the Company offers free (you are actually supposed to say it is a gift for saving the Company 7½ years of bookkeeping) a single subject oil painting of your favorite color photo. In training class we were told to tell the customer that such a painting is a \$150 to \$200 value. I called two places for appraisals of a framed 11×14 oil painting from a color photo. —'s of California (—, Los Angeles, —) said the painting would cost \$60.00 and the most expensive frame (gold leaf) would be an additional \$40.00. I also called (—) Industries (—, Glendale, —) to get an estimate for such a painting. The — representative said they only did that kind of work for — customers, but he said a good job at another place would be \$50.00 to \$75.00 for the painting and a poor job would only cost \$20.00 to \$35.00.¹²

Little more can be added to the — story, but I trust this report will be a satisfactory introduction to the world's first completely automatic electronic camera available to the public.

WHAT DO THE EXPERTS SAY?

I have included on the following page a chart showing appraisals of the value of the — by some of the most reputable Los Angeles camera dealers. You can see there was a low of no market value and a high of \$79.00. I got these figures by telling camera dealers that a friend wanted to sell this camera to me so I wanted a professional appraisal of its value. Virtually all the the people cited placed a price on the camera, all said that they would not dealers prefaced their appraisal by telling me not to buy the camera. Although

⁹ "Cold turkey" means random soliciting. The Company does not officially allow "cold turkey" canvassing. If you make a sale this way, Doug suggested you follow his example and type up your own referral letter.

¹⁰ See my Note on the Credit Application.

¹¹ I assume that "button-up" is salesman slang for getting the customer to congratulate himself for securing the painting rather than think about the price of the camera.

¹² Because — is a division of — Corporation, we can be sure that they have these paintings done at a very reasonable price.

give me anything if I wanted to sell the——to them. I am sure we could call any reputable Los Angeles camera dealer to the stand, and he would not hesitate to pan the ——.

CAMERA APPRAISAL CHART

Store, address and phone	Name of appraiser	Appraisal
		Sold ——, including case, for \$79 a few months ago.
		\$75, including case.
		"—— has no market value, but sold for outlandish prices by door-to-door salesmen."
		\$20.
		"—— sold brand new in New York for \$49.95. The case was an extra \$5."

Senator Moss. We have two more witnesses. Mr. Richard Godown of the National Association of Manufacturers. Is he here?

Mr. Godown. Yes, sir; Mr. Chairman.

Senator Moss. Will you come forward, please.

We are glad to have before us, Mr. Godown, and we ask you to proceed.

STATEMENT OF RICHARD D. GODOWN, ASSOCIATE GENERAL COUNSEL, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. Godown. Thank, Mr. Chairman. I think I should begin by saying I am associate general counsel.

I will be mindful of how we are under the pressure of time. I will start out with comments and——

Senator Moss. The statement in full will be in the record.

Mr. Godown. Thank you sir.

Not to get involved in a contest of my authorities are better than your authorities. that sounds like an argument between a husband and wife, but since your opening statement, Mr. Chairman, did contain a quotation from a prominent jurist, if I may, let me highlight a recent statement by Prof. Milton Handler, senior member of the faculty of law at Columbia University. He wrote an article in the *New York Times*, April 4, 1971, where I think you perhaps saw, this following quote:

Class actions which have been hailed repeatedly in recent months as a panacea for all sorts of consumer grievances, are rapidly becoming a ubiquitous feature of the legal landscape. A wave of emotionalism has been generated with the result that anybody who does enthusiastically endorse consumer class action suits becomes an enemy of progress and disciple of the devil.

Any device that is workable only because it utilizes the threat of unmanageable and expensive litigation to compell settlement is not a rule of procedure—it is a form of legalized blackmail. Consumer class actions have been called court clogging and inefficient. It has been stated they offer abuse by the legal profession. Fears have been expressed that these suits will result in harassment for business and full employment for lawyers.

I assure you I do not appear as the disciple of the devil today. The quote continues:

Our reason for opposition encompasses all this plus the fact we feel that these actions in the form offered are unnecessary. As we have testified before this subcommittee, it is our view that the FTC properly staffed and funded, and with

expanded jurisdiction affecting interstate commerce and one with authority to seek preliminary injunctions can and will prove more than adequate to protect the consumers. An FTC so empowered could with facility weed out that limited degree of consumer fraud which does exist and could stop such fraud in its incipency.

I would like to make these points.

Section 101 (1) (P) is the 16th unfair consumer practice listed and would include within that definition any other act or practice which is unfair or deceptive to a consumer and is prohibited by section 5(a) (1) of the Federal Trade Commission Act (15 U.S.C. 45 (a) 1). While this provision does not amount to a grant of rulemaking power, it does allow the Commission, ostensibly through case-by-case determination, to add indefinitely to the list of unfair consumer practices. And there are certain ramifications which flow from this. Under section 102 (b) of S. 984 representative class actions can be brought seeking redress for such unfair consumer practices. Because of this potential lurking in the background, if there is to be a list of these practices, violation of which is unlawful, we feel strongly that it should emanate from Congress and not from the Commission.

As we have argued elsewhere, the FTC was created and is presently structured under the concept that its actions and orders will have prospective rather than retroactive effect. To permit class suits on the basis of a Commission finding of unfairness or deception is to introduce a retroactive element and to impose an after-the-fact penalty on the defendant. One may at least have had some prior warning of the consequences of his intended act if it falls within the 15 proscribed practices set forth in section 101 of the bill. To attach the same consequences to any other act, simply because the FTC has declared it to be unfair or deceptive, we think in itself constitutes a gross unfairness.

On this point we would inquire, what action by the FTC is necessary to add to the list of unfair practices? The bill specifies that "any other act or practice which is unfair or deceptive and is prohibited by section 5(a) (1)," of the FTC Act becomes an unfair practice. Will the issuance of a complaint be sufficient to trigger a class action under section 102(b)? If so, then the Trade Commission will have been armed with an enormous economic weapon through use of which it can readily gain voluntary compliance by simply threatening to issue a complaint.

Section 102(a) would permit an individual "adversely affected" to bring a civil action against the supplier as a result of an unfair consumer practice. What may be recovered in such action is not spelled out nor is the rather imprecise phrase "adversely affected." In this instance, "Injured" is perhaps the better word.

Section 102(d) we feel establishes grossly unfair conditions for recovery of the costs of suit including attorneys' fees. Should plaintiffs prevail their path is clear. Not only can their attorneys recover their fees but the bill states these are to be awarded "from money damages which the defendant owes to members of the class who cannot be located with due diligence." Ostensibly this prevents these fees from operating to diminish each class member's award. In our view it is simply another factor which encourages litigation. It is a lot more difficult for the defendant who successfully defends himself to

recover his costs than it is for plaintiff who is successful to recover his cost. Plaintiff must demonstrate—rather defendant must demonstrate that suit was brought frivolously and with knowledge that the claim lacks probable cause and was intended to harass or intimidate the defendant.

That is a pretty high wall to have to climb over to make your case.

We conclude this testimony with a brief discussion of the administration bill, S. 1222. Its list of unfair consumer practices tops at 14 and is not open ended. It provides that the Justice Department and the Trade Commission shall have concurrent jurisdiction over the unfair consumer practices enumerated and further makes operable the now familiar "triggering device" enabling consumer class actions to be brought in Federal Court following completion of successful Government action by either agency.

We fail to see the necessity for involving an agency other than the FTC in policing industry. Similarly, we do not feel that Federal class actions are either a proper or manageable means for redressing consumers who claim injury as a result of unfair practices. The requirement for prior successful federal action as a prerequisite to bringing suit is certainly to be desired over a simple procedure which in effect clears a path straight into the courts. But it is the principle and not just the procedure to which we object. Class actions are the wrong remedy.

Finally, with regard to the administration bill, we doubt very much the necessity for extending civil investigative demand authority to the area of unfair consumer practices as would be accomplished under section 10. It is only matters sounding in antitrust and having widespread anticompetitive effects which we would consider as even approaching the necessary justification for demanding, prior to the institution of civil proceedings, documentary evidence and written answers. The phrase "fishing expedition" comes to mind and authority for such ought to be avoided.

In sum, we do not feel there is any gain to be made by providing a Federal forum for consumer class actions when the positive outcome is in all circumstances a matter of conjecture but the negative results of which—the harassment and coercion of legitimate business for no justifiable cause, the notoriety and enrichment for the lawyers and organizations involved, and the long and frequently frustrating journey through the courts for uncertain or no reward—are eminently predictable.

Senator Moss. Thank you, Mr. Godown, for your statement, and your point of view of the national association of manufacturers.

Would you agree with Mrs. Knauer that there is really a great deal of fraud and misrepresentation being practices now in the market?

Mr. Godown. I have no way of quantifying the statement, Mr. Chairman. I do not know that there is a great deal of fraud in the marketplace. It would be my position that that degree of fraud which does exist can be taken care of through means which do exist and also can be perhaps prevented by granting to the Federal Trade Commission the power to seek preliminary injunctions to halt unfair, and deceptive practices in their incipency.

Senator Moss. Of course you would not agree with the two attorneys who came from New York nor Mr. Kelley, I guess.

Mr. Godown. I think it would be fair generally to characterize my position as not agreeing with them, yes, sir.

Senator Moss. Well, I told the man from New York it was unusual to have a bar association agree of a report, so I expect we would find some disagreement among members of the bar on the matters before us.

Now I must go because I have a new meeting. My colleague, Senator Hatfield, has returned. He did not have a chance to hear this. I do not know whether you have any questions.

Senator HATFIELD. No.

Senator Moss. All right, thank you, Mr. Godown, and Senator Hatfield will now take over.

We still have a witness to be heard, Senator, and I appreciate your taking the chair.

Mr. Godown. Thank you very much, Mr. Chairman.

Senator Moss. Thank you.

(The statement follows:)

STATEMENT OF RICHARD D. GODOWN, ON BEHALF OF THE NATIONAL ASSOCIATION
OF MANUFACTURERS

Mr. Chairman, my name is Richard D. Godown. I am associate general counsel of the National Association of Manufacturers and appear on behalf of the Association. The NAM is a voluntary membership organization representing many thousands of manufacturers, large, medium and small, all of whom have a vital interest in the legislation under consideration before this subcommittee today.

A great deal has been said about consumer class actions and along the way this proposal has attracted some notable opponents. To mention two of the most eminent, Chief Justice Burger and Prof. Milton Handler. The Chief Justice, speaking before the American Bar Association in St. Louis on August 10 of last year, stated:

"The federal court system is for a limited purpose and lawyers, the Congress, and the public must examine carefully each demand they make on that system. People speak glibly of putting all the problems of pollution, of crowded cities, of consumer class actions and others in the federal courts. We should look more to state courts familiar with local conditions and local problems."

Prof. Handler, senior member of the faculty of law at Columbia University, wrote in an article in the New York Times on April 4, 1971.

"Class actions, which have been hailed repeatedly in recent months as a panacea for all sorts of consumer grievances, are rapidly becoming a ubiquitous feature of the legal landscape. . . . A wave of emotionalism has been generated, with the result that anyone who does not enthusiastically endorse consumer class action suits becomes an enemy of progress and a disciple of the devil.

". . . Any device that is workable only because it utilizes the threat of unmanageable and expensive litigation to compel settlement is not a rule of procedure—it is a form of legalized blackmail."

Consumer class actions have been labeled "a net liability;" they have been called "court clogging" and "inefficient;" it's been stated they offer opportunities for abuse by the legal profession. Fears have been expressed that expanded class action suits in federal court will result in harassment for business and full employment for lawyers. Our reasons for opposition encompass all the foregoing plus the fact that we feel consumer class actions in the form here offered to be unnecessary. As we have testified before this subcommittee, it is our view that a Federal Trade Commission properly staffed and properly funded; an FTC with expanded jurisdiction to reach unfair or deceptive acts or practices "affecting" interstate commerce; one with the authority to seek preliminary injunctions, can and will prove more than adequate to protect the interest of the consumer in the market place. An FTC so empowered could,

with facility, weed out that limited degree of consumer fraud which does exist and could stop such fraud in its incipency.

But let us now look specifically at S. 984 and its companion bill, S. 986, as well as the Administration bill, S. 1222.

S. 984 would establish a "laundry list" of fifteen unfair consumer practices with an open end so that any additional act or practice not included with the fifteen, but found unfair or deceptive to a consumer under section 5(a)(1) of the Federal Trade Commission Act would be added thereto. Hence the list of unfair consumer practices could grow indefinitely. The bill contemplates enforcement action by the Trade Commission under section 5 and, following issuance of a cease and desist order which has become final, any consumer adversely affected by the unfair consumer practice which gave rise to the order may bring a civil action against the supplier involved. Section 102(b), however, is much broader and would establish the right to bring consumer class actions in federal district court coupled only with the requirement (1) that the FTC be given ninety days' prior notice, (2) that the action be maintainable under Rule 23 of the Federal Rules of Civil Procedure, and (3) that each member of the class shall have become obligated in the amount of \$10 or more. Voluntary settlements would be encouraged with court supervision provided for settlement offers. Should plaintiffs prevail, recovery would include damages, the costs of suit and attorneys' fees. Defendants who prevail could recover the costs of defense if they were successful in convincing the court that such suit was frivolously brought, with knowledge that the claim lacked probable cause and with intent to harass or intimidate. FTC orders which had become final would serve as *prima facie* evidence in class suits under section 102.

These changes alone are considerable but when viewed in conjunction with Title II of S. 986, a companion bill, they amount to a potential for formidable and unwarranted difficulties for the business community. Very briefly, S. 986 contemplates granting FTC the authority to engage in substantive rule making, to bring suit for civil penalties for a breach of its rules, and the authority to order such broad equitable relief as it deems necessary to redress injured consumers. An NAM witness appeared before this subcommittee on March 22 to register our views in opposition to Title II.

At this point we doubt very much whether there is anything new to be said either for or against the use of class action suits in the pursuit of consumer remedies. For the record, I should like to outline the reasons why we feel that opening the federal courts to such actions would be an enormous mistake.

We feel that all manufacturers, and big concerns in particular, would fall prey to harassment and strike suits under this bill. It is small comfort to be told that plaintiffs have to prove their case. The cost of defense is formidable enough so that it cannot be winked at by any U.S. company. And the public relations damage—the adverse publicity which flows from simply being named in such a suit—is costly in other terms.

This legislation, however, is not aimed at litigation but rather at settlement. It flatly encourages class action suits by establishing simple qualifying criteria and then at section 102(c) states:

"Actions pursuant to this section for redress of consumer injury shall be administered, so far as practicable, to facilitate voluntary settlements."

Whether this is in recognition of the fact that simply defending oneself in an action involving potentially millions of consumers carries with it the threat of bankruptcy or whether it is an attempt to at least somewhat alleviate the burden on the federal courts, it clearly recognizes the problems to come. Need it be pointed out that when it is less costly to settle than to prove one's innocence, justice is ill served?

We mention parenthetically that providing, as section 102(c) does, the enormous cost of communicating settlement offers must be borne by defendants considerably weakens the impetus to settle.

The "court clogging" argument is by now familiar, i.e., that provision for consumer class actions would result in an avalanche of suits being filed and hence the federal judiciary would be unable to handle its normal case load, inevitably stranding matters of greater import. In consideration of both the money and priorities involved, the statement that, "If the courts are inadequate to provide justice, then the courts should be made adequate. If we need more judges, we should have more judges," does not seem a reasonable or a practical answer. Nor is the matter easily handled by virtue of the fact that under Federal Rules of Civil Procedure 23 a federal judge may refuse permis-

sion to bring a class action because of difficulties likely to be encountered in its management. Considerable time and energy may be expended in arriving at this conclusion; meanwhile, the judge is unavailable to handle other cases. Note also Rule 23 provides that the decision whether a class action may be maintained can be conditional and subject to alteration or amendment before decision on the merits. This means, of course, that more judicial time would be consumed.

The question of damages presents an additional problem of administration for the courts. If plaintiffs should be successful individual damages will have to be ascertained. These can be expected to vary and the facts of each case will have to be examined. When one contemplates the potential for a class numbering in the thousands or more, the enormity of the task involved in determining damages appears staggering.

Finally, we feel there are dangers for the Bar inherent in this legislation. A highly damaging situation might come about which could find lawyers competing to represent a class or filing conflicting class action suits. Also, there is the possibility of solicitation of class members and funds, and of misrepresentation regarding the purpose of the suit and of the possible effect of court orders. S. 984 is a flat invitation to litigate, with the potential for reward to plaintiffs' attorneys so great as to make them interested parties. Long experience has shown that plaintiffs' attorneys are most likely to seek out defendants with the highest settlement potential rather than go after the fly-by-night operators whose abuses, particularly of the poor and unsophisticated, are most flagrant and most in need of redress.

We turn now to a discussion of certain specific language in S. 984.

Section 101(1)(P) is the sixteenth unfair consumer practice listed and would include within that definition "any other act or practice which is unfair or deceptive to a consumer and is prohibited by section 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1))." While this provision does not amount to a grant of rule-making power, it does allow the Commission, ostensibly through case-by-case determination, to add indefinitely to the list of unfair consumer practices. And there are certain ramifications which flow from this. Under section 102(b) S. 984 representative class actions can be brought seeking redress for such unfair consumer practices. Because of this potential lurking in the background, if there is to be a list of these practices, abrogation of which is unlawful, we feel strongly that it should emanate from Congress and not from the Commission.

As we have argued elsewhere, the Trade Commission was created and is presently structured under the concept that its actions and orders will have prospective rather than retroactive effect. To permit class suits on the basis of a Commission finding of unfairness or deception is to introduce a retroactive element and to impose an after-the-fact penalty on the defendant. One may at least have had some prior warning of the consequences of his intended act if it falls within the fifteen proscribed practices set forth in section 101 of the bill. To attach the same consequences to any other act, simply because the FTC has declared it to be unfair or deceptive we think, in itself constitutes a gross unfairness. On this point we would inquire, what action by the FTC is necessary to add to the list of unfair practices? The bill specifies that "any other act or practice *which is unfair or deceptive and is prohibited* by section 5(a)(1)," of the FTC Act becomes an unfair practice. Will the issuance of a complaint be sufficient to trigger a class action under section 102(b)? If so, then the Trade Commission will have been armed with an enormous economic weapon thru use of which it can readily gain voluntary compliance by simply threatening to issue a complaint.

Section 102(a) would permit an individual "adversely affected" to bring a civil action against the supplier as a result of an unfair consumer practice. What may be recovered in such action is not spelled out nor is the rather imprecise phrase "adversely affected." In this instance, "injured" is perhaps the better word.

Section 102(d) we feel establishes grossly unfair conditions for recovery of the costs of suit including attorneys' fees. Should plaintiffs prevail, their path is clear. Not only can their attorneys recover their fees but the bill states these are to be awarded "from money damages which the defendant owes to members of the class who cannot be located with due diligence." Ostensibly this prevents these fees from operating to diminish each class member's award. In our view it's simply another factor which encourages litigation.

We conclude this testimony with a brief discussion of the Administration bill, S. 1222. Its list of unfair consumer practices stops at fourteen and is not open ended. It provides that the Justice Department and the Trade Commission shall have concurrent jurisdiction over the unfair consumer practices enumerated and further makes operable the now familiar "triggering device" enabling consumer class actions to be brought in federal court following completion of successful government action by either agency. We fail to see the necessity for involving an agency other than the FTC in policing industry. Similarly, we do not feel that federal class actions are either a proper or manageable means for redressing consumers who claim injury as a result of unfair practices. The requirement for prior successful federal action as a prerequisite to bringing suit is certainly to be desired over a simple procedure which, in effect, clears a path straight into the courts. But it is the principle and not just the procedure to which we object. Class actions are the wrong remedy.

Finally, with regard to the Administration bill, we doubt very much the necessity for extending civil investigative demand authority to the area of unfair consumer practices as would be accomplished under section 10. It is only matters sounding in antitrust and having widespread anticompetitive effects which we would consider as even approaching the necessary justification for demanding, prior to the institution of civil proceedings, documentary evidence and written answers. The phrase "fishing expedition" comes to mind and authority for such ought to be avoided.

In sum, we do not feel there is any gain to be made by providing a federal forum for consumer class actions when the positive outcome is in all circumstances a matter of conjecture but the negative results of which—the harassment and coercion of legitimate business for no justifiable cause, the notoriety and enrichment for the lawyers and organizations involved, and the long and frequently frustrating journey through the courts for uncertain or no reward—are eminently predictable.

Senator HATFIELD. Mr. Adamy, would you come forward.

You may proceed, Mr. Adamy, as you wish. Your statement will be printed, as the Chairman has indicated before. If you wish to summarize or read it, whatever you wish.

STATEMENT OF CLARENCE G. ADAMY, PRESIDENT, NATIONAL ASSOCIATION OF FOOD CHAINS, WASHINGTON, D.C.

Mr. ADAMY. It will take about three minutes if I may, sir.

I am Clarence G. Adamy, President of the National Association of Food Chains. NAFC is a nonprofit trade association of corporate food chains of the United States, representing some 225 companies ranging in size from those operating two stores to those operating as many as 4,000 stores.

I appear before you today to testify in support of the objectives of S. 984, S. 1222 and S. 1378, which can probably be most simply summarized as seeking to provide consumers with the means of securing effective and expeditious redress when they have been abused in the market place. Fortunately, I can offer such an endorsement of this objective on behalf of an industry that has a long record of positive accomplishment in voluntarily providing immediate no-questions-asked, money-back guarantees on all merchandise. Food chains can attribute a large measure of their success in gaining the confidence of the consumer to the longstanding policy of offering a simple and unqualified guarantee on all products sold, regardless of source. To my knowledge, there is no food chain in our country that does not only have this policy, but which also does not rigorously enforce it.

In this connection, purely as a matter of coincidence, at a luncheon of the board of directors of our association yesterday I listened

with interest to a serious discussion among several of our industry's leaders which dealt with how they handled one aspect of this policy. The question posed was, "What do you do when a customer returns a product that was purchased from a competitor?" The answer consistently reported by these executives was, "Replace the product or refund the purchase price and say nothing about the fact that it was not purchased at our store."

Their reasoning was that the policy is so well established that the good will gained might be lost by embarrassing the customer with the fact that she had made a mistake.

I will not detail the point further in light of the limited time available today but as discussed with your staff, I would appreciate the opportunity to supplement my statement with written comments for the record concerning these three proposals.

Senator HATFIELD. They will be received. It will be at least 2 weeks, so during that period of time if you wish to submit further material we would be happy to receive it.

Mr. ADAMY. As representative of an industry with an established voluntary policy providing for immediate redress to our customers, NAFC has followed closely the legislative interest in proposals like those under consideration today. We were particularly impressed by the thrust of the testimony offered to the Senate Judiciary Committee last year in connection with S. 3201. Without any intent to deny the consumer any right to our courts as a channel for redress, we were struck by the facts presented which outlined the workloads and resultant timelags that would frustrate the objective of prompt redress. Again, this is not offered as an excuse but it appears to be simply a fact of life. Such being the case, it would seem to me as a layman that offering such a remedy as class actions for immediate redress of fraud on consumers would in itself prove to be illusionary if not deceptive.

We would urge therefore that other devices which offer more promise of meeting the objectives be explored.

While the policy of food chains might not be applicable to all retail businesses, voluntary efforts now underway by the Council of Better Business Bureaus holds forth the promise of effective action in this direction. Likewise the work now underway by the nonprofit corporation, the National Institute for Consumer Justice, is certainly a move in the right direction in exploring the adequacy of present procedures for resolving disputes arising out of consumer transactions.

In addition there are a number of other approaches that have been suggested which deserve further examination in order to find the most effective means of serving the much desired purpose of justice in the marketplace for consumers. These will be covered in my supplemental comments.

In summary, NAFC's posture is simply that immediate consumer redress is an objective to which we subscribe as demonstrated by our actions. We remain unconvinced that consumer class action suits will effectively fulfill this objective and thus we urge further evaluation of alternative methods that could more completely accomplish the job.

Senator HATFIELD. Thank you very much, Mr. Adamy.

In your statement you talk about voluntarily providing an immediate no-questions-asked, money-back guarantee on all merchandise. And you relate further about the conversation you had with your colleagues in which the question was asked what do you do when a customer returns a product which was purchased from a competitor. I asked Mrs. Knauer this morning in the earlier part of the testimony—I don't know if you were here at the time—about the possibility of developing mechanisms in which there could be voluntary—more volunteerism, settlement of these matters without the necessity of going to court.

I see not only a problem of courts becoming flooded perhaps but—this is perhaps not the politic thing to say—but I find that oftentimes in these matters where a citizen had been agrieved or there is a right of a citizen to bring an action that it ends up the legal fees are eating up the settlement and the lawyers get the benefits—more than, say, the citizen or the party who was the plaintiff.

Would you agree that there could be strong emphasis put on the idea of voluntary settlement of these even to the point or perhaps requiring an opportunity to be given to the would-be defendant to settle these matters within class action suits or other suits before things ever get to court?

Mr. ADAMY. I would certainly urge that be broadly considered. Any voluntary action must contain the element of expedition. In the kind of injury to individuals, these are relatively small amounts of money. But the immediate reclaiming of that money or property is so valuable to them that expedition becomes a vital factor, and obviously nothing can be as fast as voluntary compliance.

That can't be the end of the statement, Senator. Obviously there would be intractable people. There are undesirable things that happen in the world. So there must be review of voluntary actions so when it refuses to work or fails to work it can be corrected. But a system that combines the best elements of voluntarism with proper supervision and review by authority would seem to be the best route to achieve the goal we all seek and we need it.

Senator HATFIELD. What impact would that have on the price structure? Is this going to be then assuming a certain factor in the pricing of goods.

Mr. ADAMY. The impact of a money-back guarantee which is a form of voluntary redress, in our industry certainly must be counted as some cost, but so infinitesimal as to be unmeasured.

Senator HATFIELD. When you indicate to us this money-back guarantee type of policy, in your industry, then actually you don't have any fear of class actions, do you?

Mr. ADAMY. Almost none, sir. We do—

Senator HATFIELD. Because you have settled in a sense?

Mr. ADAMY. The large majority we would have settled already. We are aware that an enterprising attorney with undesirable goals could find a method of harrassing us, too. We are an attractive goal.

Senator HATFIELD. We are back to attorneys again.

Mr. ADAMY. The world's undesirable people are not defined by class or profession.

Senator HATFIELD. Do you have any thoughts as to—let me back

up a minute—both the administration bill and Senator Magnuson's, S. 984? Can you talk about, or accept the concept of class action? There are varying restrictions placed on the administration's proposals of class actions, but they accept the basic proposition of class actions. Do you have any thoughts as to how these actions would be made more effective maintaining not only the right of the citizen but also the industries that provide goods and services?

Mr. ADAMY. Senator, I really believe there are better avenues to approach the goal. I agree with the goal. Total redress must be accomplished. I would suggest a look at the program suggested by the National Council of Better Business Bureaus. Arbitration might be a more useful route, And empowering the Federal Trade Commission to encourage, induce voluntary compliance with authority to supervise and override.

I would suggest there is a good possibility that a strengthening of the small claims court procedures may provide better answers, recognizing both redress and expedition, which I think are equally vital to correcting the wrong that these individuals have suffered.

Senator HATFIELD. In this money-back-guarantee policy that you have practiced, do you feel this perhaps has an impact on what would otherwise be your liability insurance costs? Lawyer and legal fees that you have or numbers of people that you would hire for legal staff?

Mr. ADAMY. I suppose so, Senator, but this is a long-term practice and you have to go way back into a different method of doing business here to make it—

Senator HATFIELD. To make the comparison.

Mr. ADAMY. Yes.

Undoubtedly you are right—if we did not have the moneyback guarantee we would have more lawsuits, but there is nothing to suggest there would be very many. We are not concerned with health or a safety, but basically with taste, quality and personal desires.

Senator HATFIELD. Do you know of any goods or services in the field of industry today where a money-back guarantee policy could not be applicable?

Mr. ADAMY. Well—

Senator HATFIELD. I don't mean to put you on the spot here.

Mr. ADAMY. No. I don't know of any, but again, I am quite an incompetent witness to this point. The average item in a grocery store sells for \$0.30. If you are talking of a several thousand dollar purchase, there would be many more caveats required to be written into the agreement to refund. I have no question that this is true. Ours business is such an absolute thing: you buy it once, you use it once, and it's gone once. An automobile, you use up some every minute, but it isn't all gone. A money-back guarantee would create different questions for different products, and I am not competent to respond here. It's a very successful procedure in our industry. I think it meets in large measure the problem you address here. I am not sure how far it could be extended. I think it should be explored.

Senator HATFIELD. It would certainly minimize the impact of any of this legislation upon the problems of doing business?

Mr. ADAMY. I would think so; sir. Yes.

Senator HATFIELD. Because of the fact both the administration bill, and Senator Magnuson's bill as I understand it, fraud is a key, where they knowingly have offered this product; but they have to prove intent to defraud or mislead the public. So that with the money-back guarantee policy, this would appear certainly to minimize the possible impact of even, say, Senator Magnuson's bill, which industry generally seems to support less than it does the administration bill.

Mr. ADAMY. Now that you remind me of it, there would be areas of trade and of consumers covered by class actions that a money-back guarantee would not be the complete answer to. As the previous witness was discussing a class action for one of these food plans where the customer buys a refrigerator and signs a food contract, in his claim in case his brings in fraud, certainly there is no evidence that money-back guarantee would meet that, but I do suggest there are other proposals more adequate to meet that need than class actions.

Senator HATFIELD. When you talk of your association with 225 companies operating as many as 4,000 stores, does this include all 50 States?

Mr. ADAMY. Yes, sir.

Senator HATFIELD. Are you familiar with the legislation or agencies at the State level and community level that play a role in this whole matter of consumer protection, and if so do you consider all these State laws and agencies are adequate to deal with the subject?

Mr. ADAMY. Yes. I think that they are really adequate to deal with the subject. There are a great many class action cases brought; for any that would be, there continues a need to improve the process of redress. Whether it's a holder in due course process that you legislate, whether it's improvement in small claims courts—because despite many, many cases, a class action, the obtaining of an attorney, the amount of money required, the darn trouble of doing it plus the long delay in reclaiming, make justice denied.

So that whereas I don't want to criticize in any way the State class action authority, I do believe it meets a great need. I don't propose to say it meets the full need as presented by this problem.

Senator HATFIELD. So you recognize the need to have some Federal legislation at this point?

Mr. ADAMY. In the arena of redress. Not necessarily class actions. Certainly we can't deny the right of a wronged individual to reclaim or be made whole again.

Senator HATFIELD. We get into a lot of argument of course about just what this would do to the courts because it's pretty much in the field of conjecture—yet isn't entirely so because we can see the load of the courts today. Of course, we have on the other side distinguished jurists—which a number were quoted by our chairman, Senator Moss—as indicating that class actions presently are being handled expeditiously and they do not anticipate big problems that they couldn't overcome in handling class actions under this legislation.

Mr. ADAMY. Well, while you were absent from the room the chairman made the comment that the real thrust and purpose of this legislation was to induce a great welling of enthusiastic movement by

the private buyer to bring such cases, and to protect the rights of individuals. I would suggest therefore the very thrust of the bill itself by his definition, I don't mean to be arguing with him in his absence, is to induce a great number of cases.

I would presume that would follow from the statement he made. Therefore, I would suggest to you that you are talking about a heavy load. Now, I don't think we are going to break down the judicial systems. We will find the ways and means to keep it running. But my point is that a judicial process must, in and of itself, be slow, ponderous, and take time. The need of the people that you are concerned with, particularly the lower economic level consumers, is for immediate—at least as expeditiously as can be achieved—redress without being rapid is not very valuable.

Senator HATFIELD. I don't think anyone would argue with you on that because we have had experiences in the criminal courts and so on. But you don't have to go beyond the District of Columbia to see the problem. At least we moved to eliminate that by increasing the number of judges and the number of courts here.

I think this could be stated as a problem many of the States have: docket problems, and with the Federal courts, it is the same thing. But I don't know that that in itself would be an argument not to move ahead with legislation that might touch these cases. Looking at the problem and responsibility we have to provide the number of courts and the number of judges to handle whatever appropriately might be placed before them to resolve. That is the responsibility we have, whether it be this legislation or other legislation we are considering. We are looking into many areas now. As I indicated earlier, we have environmental/ecological legislation. Many of these bills will have to be eventually tried and tested and resolved in the courts. This doesn't mean that we fail to take action merely because this is going to apply a heavier load to the court.

If the environmental legislation is required, we move ahead. We fulfill that responsibility but by the same token we acknowledge our responsibility to increase the courts by the numbers of courts to accommodate and handle this new legislation.

I think the same would be true here. The real problem I have—and this is not really necessary for me to express again—is that I think that peoples' frustrations as I have come to know the citizen-government relationship over 20 years of elective office, the great frustration is with the people who are dealing with the bureaucracy and trying to get action through the bureaucracy. I think I fear more the problems of a bigger bureaucracy in the Justice Department trying to deal with the citizens under the administration bill—and I am not tied or committed to any bill at this point—than the load on the courts. I think in many ways the judicial system has retained and maintained an amazing amount of public support and faith even though it has been slow at times. As contrasted to the growing lack of faith and support in the ability of legislation and executive branches to operate. If you talk to the average citizen, it's not the court as much as it is with the executive agencies, or the legislative body whether State or Federal.

Frankly this concerns me more.

We have experienced this in many areas of legislation where some agency becomes loaded down, frustrated with their workload and ineffective, and the citizen becomes less confident in the whole system of government.

Do you think this is an accurate observation.

Mr. ADAMY. I agree with you. If the alternative that we have to review are inadequate then obviously we must retreat to the courts. My point being that the court structure because it is necessarily slow, class actions included, are not necessarily the best alternative.

I only propose that you carefully review other procedures to achieve that expeditiousness. I propose to you that although the bureaucracy has the grave tendency to be bureaucratic, this does not mean we cannot conceive nor develop a procedure by which this goal can be achieved.

The method by which the goal would be achieved of individual justice does not appeal to me as being all that effective.

I have great confidence that better answers can come up, more so than this.

Senator HATFIELD. I feel the way you do on that point and my personal preference would be to be—to have this self-policed. I would much prefer to see the total voluntarism and people in local neighborhoods handling it and within industry. And my second preference would be to have it handled at the State level. Lastly, then, at the Federal level.

I think we are developing so much centralization of power in this country and the people again grow weary of the contradictions.

We have people that say "Power to the People". "Deconcentrate power."

On the other hand we are taking many actions to centralize the power. My preference would be to have citizen and industry control. We haven't reached that point.

Mr. ADAMY. I would pray for that millenium, but I am afraid that is the proper word, sir.

Senator HATFIELD. I would like to thank you for your statement, and congratulate you and your industry for moving ahead in this area. Some would argue that the role of public opinion has been a part of this and I think it probably has been and that is all to the benefit and credit of the public.

But I do feel your industry has done much to eliminate much of the confusion. Your code system of dates and so on has been cleared up so people can read the code of the products you have on the shelf. The money back guarantee policy. All these things I think you deserve much credit for.

Mr. ADAMY. Thank you, sir.

Senator HATFIELD. The next hearing will be on Thursday, at 9:30 in the morning in room 1318 of this building.

Mr. Adamy and to all the others who have been here this morning, you have all been very helpful.

Thank you all very much.

Mr. ADAMY. Thank you, sir.

Senator HATFIELD. We are in recess.

(Whereupon at 12:45 p.m. the hearing was recessed, to reconvene Thursday, April 29, 1971.)

CONSUMER CLASS ACTION

THURSDAY, APRIL 29, 1971

U.S. SENATE,
SENATE COMMITTEE ON COMMERCE,
CONSUMER SUBCOMMITTEE,
Washington, D.C.

The subcommittee was called to order at 9:35 a.m. in room 1318, New Senate Office Building, Hon. Frank E. Moss (Chairman of the subcommittee) presiding.

Present: Senator Moss, Hart, Cook, and Cotton.

Senator Moss. The subcommittee will come to order.

We are now moving into our second day of hearings on class action. We have a very full witness list today and we must keep moving along during the day if we are going to hear from everyone whom we have listed and we would like to hear from on this legislation.

OPENING STATEMENT BY THE CHAIRMAN

I would, however, like to take a moment before we start to bring to your attention the opening quotation from the *Manual for Complex and Multidistrict Litigation*, and I do this apropos to the many times we have heard stated in our hearings this year and last year—and I perhaps expect to hear them this morning—that class action is bad for consumers because it is a long, drawnout process of litigation with many years between complaint and judgment.

Now I quote from the Manual. This is the very opening quotation.

There are no inherently protracted cases, only cases which are unnecessarily protracted by inefficient procedures and management.

It seems to me that the time requirements of class action are well known to the courts and that it is something that the courts are trying to ameliorate—as the development and promulgation of the Manual demonstrates.

So let us move along. I am pleased to have all of you here today and I look forward to your testimony. In view of the extensive record compiled on class action last year, we have asked witnesses to focus their testimony on material not already in the record. In order to be fair to those who come on later today we must ask the earlier witnesses to summarize their statements so that we will have time for every one. I am particularly interested in hearing specific facts and examples rather than general arguments that we have been through over and over again and that are really applicable to any

bill that would create a new cause of action or a new judicial remedy. I would like to learn how the specific topic before us—consumer class action—would affect your industry and relate to the industry's practices and products and the experience you have had with actual cases of class action.

I am pleased this morning to have Senator Cotton, who is the ranking Republican member on the Commerce Committee of the Senate, here, and he will introduce the commissioner of the State of New Hampshire Insurance Department, and then I hope that Senator Cotton's time will permit him to remain and sit with us on the panel.

This morning is not unusual, I guess, in the Senate. We have about 25 committee hearings going in various places and since all Senators have assignments to more than one committee and several subcommittees, we all have to be in two or three places. We have to sort out our priorities—something we talk a lot about these days—and I find that many of my colleagues who would like to be here and are taking a great interest in this hearing and in the legislation are unable to join us because of their other commitments that they have to give priority to for one reason or another.

But I would hope that Senator Cotton could remain and I am sure I will be joined by other members of the subcommittee as the morning wears on.

So I call on my distinguished colleague from New Hampshire, Senator Cotton.

Senator Cotton. Thank you, Mr. Chairman.

I am glad you made my speech for me in one sense. Chairman Magnuson and I share our respective positions of Chairman and ranking minority member on both this committee, the committee on Commerce, and the Labor—HEW subcommittee of the Committee on Appropriations.

We have Secretary Richardson up before us at 10 o'clock, so I may have to leave for that purpose.

Senator Moss. That explains your priority in that circumstance, so I anticipated it.

Senator Cotton. Mr. Chairman, I know that you have a number of witnesses so I will be brief. I simply want to state what a pleasure it is to introduce to the committee Mr. John Durkin, New Hampshire's insurance commissioner.

New Hampshire has been in the forefront in passing and updating legislation so that the Department of Insurance can be effective in this field. The success which we have enjoyed has in no small measure been due to the activity and the grasp of the problem by our own commissioner, Mr. Durkin. We all feel great confidence in his ability up in New Hampshire, and it is my privilege to welcome him to the committee and present him to you.

He is accompanied at the table by Mr. Jon Hanson, executive secretary of the National Association of Insurance Commissioners. I will not take any more of your time except to welcome Mr. Durkin on my own behalf and commend his statement to the attention of the committee.

Senator Moss. Thank you very much, Senator Cotton.

We welcome you, Mr. Durkin and Mr. Hanson, and look forward to your testimony. You are speaking, of course, for a very important, prestigious group of government servants, the insurance commissioners of the States, and I am glad that Senator Cook of Kentucky has now joined us. He is one of the most diligent and knowledgeable members of this subcommittee on the subject that we have before us.

You may proceed, Mr. Durkin, in any way you would like. I will make a general announcement in the beginning, that all of the prepared statements that are presented will be put in the record in full. This will enable any witness who wishes to summarize or highlight parts of the testimony that he would like especially to call to our attention. But the entire matter will be in the record and, therefore, he does not need to feel constrained to read every word of it.

However, each witness may proceed in the manner he wants to proceed, and I just make that as a general announcement to begin with.

STATEMENT OF JOHN DURKIN, COMMISSIONER, STATE OF NEW HAMPSHIRE, INSURANCE DEPARTMENT, CONCORD, N.H.; ACCOMPANIED BY JON S. HANSON, EXECUTIVE SECRETARY, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. DURKIN. Thank you, Mr. Chairman. Thank you, Senator Cotton.

My name is John A. Durkin. I am appearing on behalf of the National Association of Insurance Commissioners, commonly referred to as the NAIC, both as the insurance commissioner of the State of New Hampshire and as the cochairman of the NAIC subcommittee on Unfair Trade Practices. As Senator Cotton said, with me is Jon Hanson, the executive secretary of NAIC. Having its inception in and regular meetings since 1871, the NAIC is the oldest voluntary association of State officials. It includes the principal insurance regulatory authorities of the 50 States, the District of Columbia, and territories of the United States.

Acting on your suggestion, Mr. Chairman, rather than read our full statement, I shall summarize the highlights orally and submit our written statement for your consideration and for the record.

Senator Moss. Thank you. You may proceed in that manner.

Mr. DURKIN. Senator Magnuson's bill, S. 984, the Administration's bill, S. 1222, and Senator Bayh's bill, S. 1378, seek to enhance the protection of the consumers from unfair trade and deceptive practices. The NAIC concurs with this general objective since the protection of the consumer is the fundamental purpose upon which State insurance regulation is based. However, until we complete our current review, the NAIC has taken no position either favoring or opposing the concept of class action. Nevertheless, the NAIC is vitally concerned over the potential adverse impact these Federal class action bills, as they are currently drafted, may have in diminishing the overall level of consumer protection for the insurance consuming public.

In short, for several reasons, the NAIC opposes the inclusion of insurance services in the bills due to adverse ramifications posed by

the McCarran Act problem. Application of the Federal Government triggering concept to insurance could lead to an adverse effect on the carefully constructed balance between antitrust concepts and the complex system of insurance regulation.

In the area of protecting the consumer against unfair trade practices there already exists a detailed and comprehensive insurance regulatory mechanism at the State level. State insurance regulation provides a wide range of standards, powers, and remedies which go far beyond those available to the Federal Trade Commission. The intrusion of a Federal regulatory agency would create a duplication and conflicts between State and Federal law, both substantive and procedural, and at an increased cost to our taxpayers, or such inclusion might ultimately preempt this regulatory area thereby resulting in a more narrow, less protective system of regulation than that now provided by the States.

We submit it would be poor public policy to interject the FTC in the complex insurance regulation when it is currently overburdened, understaffed, and subject to much unanswered criticism, especially when you consider the field is already comprehensively and effectively covered at the State level.

While the NAIC has taken no position for or against class action, intense regulation on behalf of the consumer lessens the need for class action. Furthermore, the State provides an effective local, readily accessible complaint mechanism available to the consumer which serves as an alternative to class action.

The proposed legislation provides no means of coordinating the FTC, Federal court decisions, and State insurance department activities. This, in turn, might well lead to anarchy in regulation and hence diminish insurance industry effectiveness in serving the public need. If someone set out to create intentionally a symphony of chaos, a more effective vehicle is difficult to comprehend.

The involvement of the FTC, we feel, is unnecessary inasmuch as there has been no demonstrable need. The States are solving the problem today. They have the power and the knowledge of how to apply it, while the FTC is untried and untested in this area. States have many powers. We have the complaint procedure. We license agents and brokers, adjustors and companies. We have annual reports—quarterly reports. In New Hampshire the domestic companies are on a quarterly reporting system. We have periodic examinations, approval of policy forms, rate regulation. We have the Unfair Trade Practice Act, the model act which has been enacted in all 50 States. We have the rehabilitation and liquidation procedures available to the commissioner in the event that he is having an undue amount of difficulty with a company, and we have civil and criminal penalties.

I submit that State controls are more extensive than those available under the Federal Trade Commission Act. They are tried and tested methods. Enactment of these proposals with insurance services would overburden the Federal Trade Commission and disrupt, if not destroy, an effective State supervisory system.

Let me give you some of the New Hampshire experience with respect to complaints. Last year we had 1,250 complaints and we were instrumental in recovering some \$306,000 for the people in New

Hampshire. Our complaint setup is as follows: We have an adjuster who has had 10 years experience in industry who is primarily in charge of our complaint procedure. He can refer to the department attorneys, the department actuaries, life actuary, or casualty actuary, and the life and property division for any areas he is not completely familiar with. He delivers a claim reporting form to me monthly which lists the companies and number of complaints, and if it appears that a company has an undue number of complaints we look at the annual statement. In days past there has been a correlation between the increasing number of complaints and the dwindling amount of surplus. This is a very effective tool we have with which to keep an eye on the financial stability of a company.

Also, it gives us an opportunity to talk to the responsible officials in that particular company if the claims and complaints reach what we consider an inordinate level. Last year we talked to some 15 companies and informed them that we would like them to improve their handling of claims, and they have agreed and the situation has improved.

In addition to the particular complaint procedure, we have one of the toughest automobile cancellation and nonrenewal laws in the country, and anyone who is concerned that their insurance might have been cancelled or nonrenewed not in accordance with the law is encouraged to contact the department, and some 250 people did last year. The number is increasing this year as they are more and more aware of the procedure.

One of the beauties of a small State, and how we can regulate in a small State, is indicated by a story, an actual incident of a couple of years ago. On a Wednesday before the Thanksgiving weekend, with the first snowstorm of the year predicted, I received a call from one of our agents in the north country saying he had received a solicitation from a company offering snowmobile insurance at bargain rates. By moving as quickly as possible, that night at approximately 9:00 o'clock, we had determined that there was no such company and they probably were not going to offer any coverage, and we were able to get out a press release warning the people in the State of New Hampshire; and it subsequently turned out that we could not find anyone that was victimized by this particular strategy.

Again, there has been some criticism of the small States but the small States have the beauty of usually knowing what is going on. To put it plainer, we sort of have our finger to the wind. It is not long before a person who has a complaint—in New Hampshire, a man can get to the Governor in 2 or 3 days, so you can figure out how fast he can get to the insurance commissioner.

Senator CORRON. If I may interrupt with a quick question, what did you do with the fellow who was perpetrating that fraud?

Mr. DURKIN. He was from out-of-state and we could not get jurisdiction over him, but we turned the matter over to the attorney general, but there was difficulty in getting jurisdiction. The interesting thing was we prevented anyone from being victimized.

I think New Hampshire is a good example of what a small State can do to effectively regulate insurance. Some of the other States—some of the larger States—I think you are all familiar with the rec-

ord of the larger States. I would just like to update the California figures from those in the statement. In 1970, the State of California processed some 20,200 complaints as opposed to below 18,000 last year. In 1970, they recovered approximately \$3.7 million as opposed to \$3.5 million last year.

A medium sized state or a little smaller than California, I suppose, is Missouri, and just recently they have been instrumental in requiring a company to refund in excess of \$4,000 for overcharges on assigned risk policies.

So I hope this demonstrates that the States are better equipped to do the job and they have the staff. They have a budget that greatly exceeds that of the FTC, and as the Nader Report indicated on page 87, paraphrasing the report, the present—which I believe would be the 1968—budget of the FTC would have to be increased eight or nine times, as a minimum, and I do not know that they contemplated the insurance aspect of it when they used that eight or nine times figure.

Senator Tydings, in his statement, has indicated his opinion that one agency could not be responsible for protecting the whole country. One could not do it all. And Commissioner Jones indicated on page 104 of her testimony at one of the hearings, and I quote,

I don't know whether she realized it or not, but I think she was referring to the informal system that the States have.

We can go to court or we can have a little "woodshed" session. We have complete flexibility. We have both formal and informal procedures.

I submit that any function that can be provided at the State level should be provided there, and it makes better sense to me—and I hope to you gentlemen—that it would be wiser to test the provisions of S. 984 in the general business area before disrupting an effective system of State insurance regulation with the resultant anarchy and chaos and lack of protection of the consumer, or reduction of the amount of protection.

The FTC has yet to prove itself, whereas the NAIC and the States have never more effectively operated and are improving steadily. The track record of the NAIC in the last 5 years is exemplary, and due to the recent changes in power in many of the State capitals last November we have seen a number of new commissioners appointed. I have met most of them and I can say that they are exemplary individuals. I think the NAIC is bound to improve with the addition to our ranks of these high-type individuals.

Therefore, my recommendation and the recommendation of the NAIC, is insurance services be stricken from section 101, No. 6.

Mr. Chairman, I will be glad to try to field any questions that you might have.

Senator Moss. Thank you very much, Mr. Durkin, for your statement, and your full printed text which will be in the record.

As I understand it, although you do not take a position—or the NAIC does not take a position either for or against the concept of class action, you do feel that insurance should not be included as one of the items to which class actions would apply should this bill become law. Is that right?

Mr. DURKIN. Yes, sir.

Senator Moss. Do you have class action procedure within the State of New Hampshire that would lie in the State court in the event the policyholders, for instance, wanted to sue as a class?

Mr. DURKIN. We do not have it under the insurance laws. However, if we had a case where there was demonstrable fraud established we have the implied power as the State of California has, to go a long way towards forcing the companies to make refunds, and this power was demonstrated in New York some years ago on overcharging, and in California, and we have that same power. But the class action power per se, in the insurance law, no.

Senator Moss. Well, if the State and the Federal Government courts had concurrent jurisdiction so that a class action could be brought within the State if the members of the class were all in that State or in Federal court if there were members of the class widely dispersed in several States, do you think that would be desirable in the insurance field or not?

Mr. DURKIN. No, sir. I think the best remedy would be to remove insurance services completely from the bill.

One problem with having the concurrent jurisdiction that comes to mind immediately is that you run the risk of having case law growing out of the class action suits that would conflict and disrupt the very effective State system we now have without adding any increased degree of protection. I think it would probably detract or lessen the amount of protection the people have now.

Senator Moss. Well, under the regulatory system that the States have on insurance, if the insurance company becomes bankrupt, they have to avail themselves then of the Federal court procedures in bankruptcy; is that right?

Mr. DURKIN. No, sir. We are quite proud of that. We have—New Hampshire was one of the first States to enact an insolvency protection law, which in its original form covered only automobile insurance, which provides that the other companies are assessed an amount sufficient to remove the deficit. So every claimant is made whole and the liquidation proceedings under one NAIC model act are vested basically in the States.

It is primarily a State jurisdictional problem and is handled very well on that level.

Senator Moss. This is getting off into another field and I will not pursue it any further, but we have been considering a bill in this committee about whether or not there ought to be that kind of an insurance pool fund on a national basis for insurance companies that become defunct. Many of the States have not been as enlightened as New Hampshire and have had insolvencies of insurance companies where the policyholders lost.

Mr. DURKIN. Mr. Chairman, I think that highlights the point that I intended to bring up and I may have glided over it.

The track record of the NAIC is excellent. I think today the Insolvency Protection Act is a law in over 30 States—I think 32, the last I knew, and this all since 1969 when we first started in New Hampshire and Michigan and California. So the NAIC has shown it has its finger to the wind and can move quickly.

Senator Moss. As part of your statement you said that the FTC, because of its limited personnel and for other reasons, could not protect the whole country. I wondered if that was not a bit of a rationale, perhaps, for this idea of having class action.

If the consumer must move through FTC or Justice in order to recover, and they cannot cover the whole country, which obviously I think is a truism, would it not then release the consumer mechanism so that he does have some place where he can get relief by bringing class action?

We are not talking now about insurance, but just general consumer frauds or deceptive acts that brought on this loss.

Mr. DURKIN. It might provide the rationale for general business practices that are not extensively regulated, but conversely, I think it provides the rationale for excluding insurance when you realize the degree of regulation of the insurance industry; and I submit that in most cases that the insurance department action is quite rapid.

Another local story, a friend of mine practicing law in Manchester complained to me one night—some of the lawyers keep their offices open on Thursday night—that this lady came in and said, “I have a complaint. I have a claim. My neighbor went to the Insurance Commissioner and got the claim settled in 3 days. Can you beat that or shall I go to the Insurance Commissioner?” I think that indicates the speed, as opposed to the class action, with which the Department can move.

Senator Moss. Maybe you are being unfair to lawyers up there. You are taking business away from them. That, of course, is a remarkable thing if within 3 days you could get a claim settled. I do not suppose any lawyer could offer to compete with that, even if the jurisdiction were there.

You mentioned a current review that your association is undertaking. Could you tell me what this current review is that you are talking about?

Mr. DURKIN. Yes, sir. Fletcher Bell, the commissioner from Kansas, and I are cochairmen of a subcommittee to review the Unfair Trade Practice Act, the model act. One of the things we want to review is the possibility of restructuring that act to possibly reflect the conditions that exist today as opposed to the mid-'40's when that was enacted after deliberations by the NAIC.

In that light, we had a meeting Tuesday, the first meeting of this subcommittee, in Santa Fe, N. Mex., and we hope to meet again and we will meet again at the June NAIC full plenary session in New York.

Even as proud as we are of the State system, we realize that there is a possibility that it could be improved, too, and this is what we are looking at.

Senator Moss. I see. Thank you very much. Senator Cook?

Senator Cook. Commissioner, in effect, what you are really saying is that under the present system, the respective States would give more protection to the insurer than any of the inclusions in the respective bills that are presently before this committee. Is that, in essence, what you are saying?

Mr. DURKIN. Yes, sir.

Senator COOK. In essence, you are saying that the FTC, which has a \$15 million budget, and has all of the other problems that it has, cannot compete with the respective States, which have over a \$40 million budget for the protection of the citizens of the respective States in regard to insurance claims. Is that not true?

Mr. DURKIN. Yes, sir.

Senator COOK. We talked last year about the fact that in the so-called Playboy Clubs, the lawyers were paid \$270,000 in fees. This has very little consequence when you look at the record of the State of California, where the State agency processed over 20,000 claims and collected for its insurers over \$4 million. So there really is not much of a comparison, is there?

Mr. DURKIN. No, sir. Even in New Hampshire, we collected \$306,000, which is a lot of money for a small State.

Senator COOK. Are you concerned that under these acts the FTC may, in fact, preempt the entire field in regard to State laws?

Mr. DURKIN. That is a distinct possibility and the preemption could occur without the physical resources or the manpower to adequately protect the area once they have preempted it.

Senator COOK. What protection would an insured have in a given State in which the FTC must hold a hearing, the FTC must come to a conclusion, in which the FTC must have evidentiary hearings; where respective State laws right now could serve notice on complaints rendered on a series of complaints, that an insurance company many have its charter in that State revoked unless it gets its house in order?

The people in that State would stand back and say, "Well we wonder how many of us will be bilked while the FTC gets around to holding a hearing," do you not think so?

Mr. DURKIN. Sir, the story I gave about the agent calling me on the snowmobiles—I do not think he would have called any Federal agency or tried to reach one.

Senator COOK. I say this because remarks that were made 2 years ago to the Commerce Committee in regard to some legislation that was presently before it dealing with the FTC, referred to the FTC, in terms of the chronic neglect of consumer needs, incapable, bureaucratic, inept and neglectful.

Now, is that the kind of agency to which you want to turnover, conceivably, all of the life blood of the insurance companies of the United States; rather than leave it to the respective agencies that now have over 5,000 employees who deal exclusively with insurance companies; when the FTC in all of the work that it does, have only 1,200 employees? Do you think this is saying to the American people that we are going to give you better protection and that we are going to look after you better by preempting the field, and by giving authority to the FTC, which cannot get its work done now?

Mr. DURKIN. I would not think so. I think you would have less protection.

Senator COOK. Mr. Chairman, I would like to put in the record, by reference if I may, the statement of the Hon. Richard Barger, who was the commissioner of insurance of the State of California, who testified before the Judiciary Committee last year in this regard, and

who set forth very plainly the fear of preemption in this field, the fear that the FTC is now so totally and completely overburdened, that the insured in the United States will get practically no service at all; whereas now, he is getting very fine, and certainly more than adequate, service from the respective insurance departments in the respective States.

Senator Moss. I think Mr. Barger testified before us last year, too, and it is in our record there.¹ So we will include that, of course, by reference, and the statement before the Judiciary Committee² as well.

Senator Cook. Thank you.

Senator Moss. We appreciate your statement, Mr. Durkin. I might point out, whether we throw them at the mercy of the FTC or not is the antithesis of what this bill proposes. It says, let the consumer have access to the courts rather than having to go to the Trade Commission and have the Trade Commission serve them or Justice. But we do appreciate your testimony, and we have had this question about whether insurance ought to be included or excluded up before, and I think you will find in at least some of the bills that it is definitely excluded.

Thank you very much.

Mr. DURKIN. Thank you.

(The statement follows:)

STATEMENT OF COMMISSIONER JOHN A. DURKIN, INSURANCE COMMISSIONER OF THE STATE OF NEW HAMPSHIRE, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

My name is John A. Durkin. I am appearing on behalf of the National Association of Insurance Commissioners, commonly referred to as the NAIC, both as the Insurance Commissioner of the State of New Hampshire and as the Co-Chairman of the NAIC Subcommittee on Unfair Trade Practices. Having its inception in and regular meetings since 1871, the NAIC is the oldest voluntary association of state officials. It includes the principal insurance regulatory authorities of the 50 states, the District of Columbia, and territories of the United States.

With your permission, Mr. Chairman, rather than read our full statement, I shall summarize the highlights orally and submit our written statement for your consideration and for the record.

Senator Magnuson's bill (S. 984), the Administration's bill (S. 1222) and Senator Bayh's bill (S. 1378) seek to enhance the protection of the consumers from unfair trade and deceptive practices. The NAIC concurs with this general objective since the protection of the consumer is the fundamental purpose upon which state insurance regulation is based. However, until we complete our current review, *the NAIC has taken no position either favoring or opposing the concept of class actions.* Nevertheless, the NAIC is vitally concerned over the potential adverse impact these federal class action bills, as they are currently drafted, may have in diminishing the overall level of consumer protection for the insurance consuming public. We refer to this as the McCarran Act problem and will explore in this statement how it may arise and its potential ramifications.

A. WHEN IS THERE A MCCARRAN ACT PROBLEM?

In 1944, in the *U.S. v. Southeastern Underwriters Association* case, the U.S. Supreme Court for the first time held that insurance was interstate commerce, thereby subjecting the insurance business to Congressional power under

¹ See p. 371 of the Senate Committee on Commerce hearings record serial No. 91-48, Pt. 2.

² See p. 136 of the Senate Committee on the Judiciary hearings of August 28, 1970.

the commerce clause. This, in turn, cast doubt on the validity of the long existing structure of state insurance regulation. Furthermore, the potential application of the federal antitrust laws created a crisis of fundamental proportions for the functioning of the insurance industry and the public it served.¹ Thus, Congress enacted the McCarran Act² providing that the insurance business shall be regulated and taxed by the states.³ Furthermore, the Act declares that federal legislation adversely affecting state insurance regulatory law shall not apply to the insurance business "unless such Act specifically relates to the business of insurance."⁴

Consequently, for federal class action legislation to raise the McCarran Act problem, it must (1) specifically refer to insurance and (2) possess sufficient adverse regulatory import on state insurance regulation. Unlike S. 1222, both S. 984 and S. 1378 specifically include "insurance services." Thus, the key question from our perspective is the regulatory import of the latter two bills.

S. 984 sets out a laundry list of 16 unfair consumer practices, including a general omnibus provision which is couched in terms of goods and services with "services" defined to include "insurance services." The bill authorizes a consumer allegedly injured by an unfair consumer practice to bring a civil action following the "trigger" of a successful FTC action under Sec. 5 of the FTC Act as to unfair consumer practices. This trigger, coupled with specific reference (and hence applicability) to insurance would seem to implicitly authorize the FTC to exercise regulatory authority over insurance. Hence, it raises the McCarran Act problems. In turn this could conceivably lead to the creation of broad substantive federal insurance law. Thus, such a statute may place a much greater emphasis on regulation, vis-a-vis consumer suits by private individuals, than is commonly realized.

S. 1378, which does not have the trigger, as well as S. 984, raises the McCarran Act problem in another context, although to a lesser extent. To the extent that the statutory (laundry list) definition of unlawful consumer practices (enforceable by class actions) and court decisions interpreting and applying such definition influence the conduct of the insurance industry, it may do so in a manner so as to conflict with state insurance regulatory law.

In short, S. 984 and S. 1378 in attempting to apply the federal class action concept to the insurance business goes significantly beyond implementing that concept. S. 984 interjects a federal regulatory mechanism into an area long and comprehensively regulated by the states. Both S. 984 and S. 1378 create law potentially conflicting with that of the states. These we submit are contrary to the public interest. Thus the NAIC opposes the inclusion of "insurance services" in these bills.

B. THE ADVERSE RAMIFICATIONS POSED BY THE MCCARRAN ACT PROBLEM ARISES

What are some of the adverse ramifications posed by a federal class action bill which creates the McCarran Act problem?

1. *Impact on Congressional Policy of Blending Antitrust and Insurance Regulatory Concepts and Upon the Availability of Coverage*

S. 984, as it might apply to insurance, could severely affect, if not destroy, the long standing Congressional policy of blending antitrust concepts with the complex system of insurance regulation in a manner to permit the insurance industry to effectively function in serving the insurance buying public. This is especially true in light of today's market capacity problems.

You may recall that when the Supreme Court in 1944 held for the first time that insurance was interstate commerce, a crisis of monumental proportions was imminent, particularly concerning the potential application of the federal antitrust laws. Overnight, coordinated activity by insurers, to spread risks among a number of insurers for those businesses with large risk exposure were threatened with loss of protection as were occupations with heavy risk

¹ See pp. 4 to 6 *infra* for further exploration.

² 59 Stat. 33 (1945); 15 U.S.C.A. Secs. 1011-1015.

³ "The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business." *Id.* at Sec. 1012(a).

⁴ *Id.* at Sec. 1012(b). This section goes on to provide that the Sherman, Clayton and FTC Acts shall apply to the extent that the insurance business is not regulated by state law. However, due to state regulation of insurance unfair trade practices, the FTC has had trouble asserting jurisdiction under this provision.

concentrations covered by workmen's compensation, group insurance, etc. Such businesses, for example, might include aviation, oil, natural gas, agriculture, cotton, chemicals, mining, steel, livestock, lumber, railroad, manufacturing, retailing, and construction.

After many months of extended joint hearings and deliberation by the Senate and House judiciary committees, Congress concluded that (a) across the board application of the antitrust laws would bring many legitimate and essential functions of the insurance business to a virtual standstill and (b) the failure of Congress to act would result in overturning the long existing system of state insurance regulation which was specifically attuned to regulating the insurance business on behalf of the public in a multitude of ways alternative to the application of the antitrust laws. Consequently, Congress sought to blend the antitrust laws with the complex system of insurance regulation by enacting the McCarran Act which stated that "continued regulation and taxation by the several states of the insurance business is in the public interest." However, Congress did provide that (a) the Sherman, Clayton and FTC Acts should apply to insurance to the extent that antitrust concepts prohibiting coercion, boycotts and intimidation would apply. In response, the states, among other things, enacted unfair trade practice acts which include prohibitions against unfair methods of competition as well as against unfair or deceptive acts or practices. In short, through the McCarran Act and subsequent state action, insurance regulation and antitrust concepts were carefully combined in a balanced legislative program.

The inclusion of insurance in a class action bill ignores this essential and careful balance. It could enable the FTC to alter the application of antitrust laws to insurance as well as regulate unfair trade practices. The bills make no effort to blend their proposed powers with the complex system of insurance regulation. In marked contrast to the careful course followed by Congress in 1944-45,⁵ the inclusion of "insurance services" reflects little thought as to the endless confusion, regulatory overlap and the impairment of the insurance industry's ability to serve the public in providing needed coverage for an ever-growing insurance market.

2. State Unfair Trade Practices Act

In the area of protecting the consumer against unfair trade practices, there already exists a detailed, comprehensive, and highly effective insurance regulatory mechanism at the state level paralleling that of the FTC.

Responding to the McCarran Act's invitation,⁶ the NAIC developed a model unfair trade practices act.⁷ Every state has enacted legislation of this type which the Supreme Court has held to preclude FTC jurisdiction.⁸ Similar to Sec. 5 of the FTC Act, Sec. 3 of the model act prohibits unfair methods of competition or unfair or deceptive acts or practices in the business of insurance.⁹ Sec. 4 defines eight general areas of unfair practices which fall within the prohibition:

- (1) Misrepresentations and false advertising of policy contracts;
- (2) False information and advertising generally;
- (3) Defamation;
- (4) Boycott, coercion and intimidation;
- (5) False financial statements;
- (6) Stock operations and advisory board contracts;
- (7) Unfair discrimination; and
- (8) Rebates.

⁵ As evidence of the extensiveness of the inquiry, we note that the Senate and House Judiciary Committees held joint hearings commencing on Oct. 20, 1943, and continuing through June 23, 1944, covering 6 parts and 642 pages of testimony. In addition, the Congressional Record shows 11 pages of discussion on the Conference Report on Jan. 25, 1945, and 12 pages on Feb. 27, 1945.

⁶ 15 U.S.C.A. Sec. 1012(b). See note 4 *supra*.

⁷ Reprinted in 2 *Proceedings of the NAIC* 509 (1960). Although prior to 1945 many states had statutes or regulations on false and misleading advertising, the McCarran Act supplied the catalyst for a comprehensive nationwide effort resulting in the Model Act.

⁸ See *FTC v. National Casualty Co.*, 357 U.S. 560 (1958).

⁹ The general standard and prohibition of the Model Act is very similar to Sec. 5 of the FTC Act. NAIC Model Act Sec. 3 provides that "No person shall engage in this state in any trade practice which is defined in this Act as, or determined pursuant to this Act to be, an unfair method of competition or an unfair or deceptive act or practice in the business of insurance."

FTC Act Sec. 5 provides that "(a) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful."

Furthermore, the insurance commissioner has authority under an omnibus provision to define additional practices as being unfair. Provision is made for cease and desist orders, injunctions and penalties. In short the state unfair trade practices acts provide a comprehensive and flexible regulatory mechanism which parallels the FTC Act, but unlike the proposed federal bills, they are specifically tailored to the complex problems of the insurance business.

3. *Synopsis of State Powers, Remedies and Sanctions*

The report of the Senate Committee on Commerce on the Consumer Protection Act of 1970 (S. 3201 in the last session)¹⁰ maintains that such legislation is needed because of the "incapacity" of the FTC and of the judicial system and the lack of sufficient sanctions, remedies and deterrents. At the same time, however, the report evidenced no consideration or awareness as to insurance concerning the panoplies of powers functioning at the state level and the extent to which these go far beyond that available to the FTC. Thus, we believe it important to summarize some of the highlights of the state insurance regulatory system.

(1) Insurers and agents as well as claims adjusters in many states must obtain and continue their licenses in order to do business. This, in turn, requires meeting financial standards concerning assets, investments, reserves, and qualifications as to character of management, experience and knowledge of the business. Licenses may be suspended or revoked for failure to comply with the law or when the public interest so requires.

(2) Insurers must file comprehensive annual reports under oath in each state in which they do business.

(3) Insurers are subject to comprehensive periodic examinations which includes, among other things, a review of whether claims are paid on a fair and prompt basis and whether policyholder complaints are handled promptly and fairly.

(4) By virtue of statutory standards on policy content and the commissioners policy form approval or disapproval power, much of the source of misrepresentation or other unfair practices is deterred in advance.

(5) Control is exercised over the pricing practices of property and liability insurers through implementing the standards that rates shall not be excessive, inadequate or unfairly discriminatory. Health policies must meet the standard requiring benefits to be reasonable in relation to premium.

(6) Market practices are controlled by, among other things, the unfair trade practice acts discussed above.

(7) The insurance commissioner may, for a variety of causes (e.g., insolvency, refusal to comply with orders, failure to remove officers, etc.), apply for a court order of liquidation, rehabilitation or conservation.

(8) Among the sanctions available for enforcement of the insurance laws are criminal and civil penalties; cease and desist orders; injunctions; removal of officers and directors; fines; revocation of (or refusal to renew) licenses of agents, adjusters, brokers, insurers; etc. These powers and sanctions, plus the informal powers, sanctions and alternative modes of relief stemming therefrom, extend far beyond what is being talked about in connection with the proposed federal class action bills even though the Committee report makes no reference to them.

4. *Impact on Overall Consumer Protection*

Today we have summarized some aspects of state regulation on behalf of the insurance buying public with particular attention focused in the area of unfair and deceptive practices. State controls are persuasive. In the insurance field, they fully occupy the area covered by the FTC Act in non-insurance businesses. Furthermore such state controls are not only similar to but also more extensive than those available under the FTC Act. In this light, what would be the impact of a proposed federal class action legislation which includes "insurance services," especially if it also provides for a federal trigger?

S. 984, for example, could very well, in effect, supersede part of the McCarran Act as to the inappropriateness of FTC regulatory jurisdiction of the insurance business. In turn, this would do one of two things.

(1) It would set the stage for duplication or concurrent regulation by the FTC and the states. The enumerated unfair consumer practices would also be

¹⁰ S. Rep. No. 91-1124, 91st Cong. 2d Sess., August 14, 1970.

covered by state law. There would be duplicative or overlapping state and federal procedures. Furthermore, in dealing with the broad and general concepts, inevitably disagreements would occur between state and federal authorities which may very well result in conflicting procedures and incompatible rules of substantive law. The taxpayers would be asked to bear increased costs of an already large overburdened regulatory agency to merely duplicate some functions already assumed at the state level. This certainly seems inconsistent with the trend to retain or move functions back to the states—a trend which is so necessary to a federal system.¹¹

Or, the bills might be construed as creating a federal preemption of this field or ultimately lead to this result. If this occurs, a more narrow and less protective system of regulation would supplant a more comprehensive time tested system of state regulation.

Incidentally, the trigger concept was apparently introduced to prevent nuisance or strike class action. But, because of the criticism that the consumer would have no relief in the event of FTC inaction, this safeguard has been significantly watered down. It seems ironic that a prime cause of the McCarran Act problem—i.e., the trigger—no longer effectively serves the purpose for which it was designed, yet it is nevertheless retained.

5. Unnecessary Overburdening of the FTC

In light of current criticisms of the FTC's failure to perform its consumer protection functions with respect to business in general, it would be unsound public policy to further dilute whatever effectiveness it has by delegating to the FTC those functions in the specialized insurance area already being performed by the several states.

The FTC is involved in over 50 different types of business enterprises whereas the state insurance departments specialize in one. The FTC has 13 field offices whereas the states provide a regulatory machinery with at least one local office in every state and multiple offices in several states. The FTC's budget was approximately \$17 million (for the fiscal year ending June 30, 1969) in contrast to state insurance department budgets aggregating over \$46 million (for the year 1969). The FTC employs approximately 1200 persons in contrast to the states nearly 4800. Thus the interjection of the FTC at the taxpayers expense, would duplicate or supersede state insurance regulation with an agency having fewer offices, dollars and people spread over the entire spectrum of American business, an agency which the Commerce Committee described in terms of "the chronic neglect of consumer needs," "incapacity," "bureaucratic ineptitude and consumer neglect."

It might be noted that the Annual Report of the FTC (1968) indicated that the Commission received 7500 complaints annually. Testimony last year suggested that the FTC acted upon only 10% of those filed due to understaffing and underfunding. Contrast this to the service provided by the state insurance departments. *Individual* state activity ranges as high as handling and closing approximately 22,000 complaints and investigations per year.¹² For these reasons, among others, we submit that it would be poor public policy to *add to the burdens* of this allegedly ill equipped malfunctioning organization and further dilute what effectiveness it might have by interjecting the FTC into the complex system of insurance regulation.¹³ Furthermore, the FTC report states that "still another approach to bringing its workload down to manageable proportions was to actively encourage the states to move more effectively against business chicanery."¹⁴ Thus, it seems ironic to enact legislation which would impede state's efforts in an area which is already comprehensively regulated by them.

¹¹ When the Consumer Protection Act of 1970 was introduced last session it exempted from the definition of "services" the providing of credit and the adequacy of service of common carriers "to the extent regulated." The Senate Commerce Committee report, August 14, 1970, p. 14, states that these exclusions are "intended to prevent duplicating and possibly contradictory regulation of goods and services elsewhere federally regulated." Clearly the avoidance of duplicatory regulation is sound public policy. It is also federal policy, by virtue of the McCarran Act, to keep insurance regulation in the states. Both existing federal policies, as well as consistency, lead to the conclusion that insurance services should be deleted from the bill.

¹² See pp. 12 to 14 *infra* for additional detail on individual states.

¹³ "By law, the FTC's enforcement jurisdiction covers virtually the entire nation. In practice, the commission has never had financial or manpower resources commensurate with the vastness of its legal jurisdiction." Kohlmeir, *The Regulators* 90 (1969).

¹⁴ Annual Report of the FTC: 1968 p.3.

6. Insurance Department Complaint Procedures: An Alternative to the Class Action

Whatever the merits of the class action approach, the existing system renders this concept less necessary in the insurance area. First, unlike most business areas to which the proposed bills would apply, insurance is subject to intense regulation *on behalf of the consumer*. The need for private class action is less than in other areas. Inadequacy of private remedies gave rise to insurance regulation in the first place.

Second, insurance departments have established some type of complaint procedure available to the consumer seeking relief from an alleged wrongful practice. As indicated by my earlier summary of powers and sanctions available to the insurance commissioner, he occupies a strategic position possessing extraordinary influence to compel redress of justified complaints (e.g. the possibility of license revocation, public hearing, injunctions, policy disapproval, fines, penalties, etc.)

A few states can illustrate the nature and extent of state insurance department activity in servicing complaints of the insurance public. Among the larger states, for example California, processes approximately 18,400 complaints and investigations per year. In 1969 the complaint bureau in New York City and Albany closed nearly 22,000 complaints and investigations of which 47% were upheld or adjusted. In 1969 Illinois opened more than 11,000 cases and closed 10,900 with an indication that approximately 30% of the complaints were meritorious. During a three year period ending in 1970 the Pennsylvania Insurance Department's Policyholders Service Division opened nearly 45,000 cases (on average 15,000 cases per year) and closed nearly 38,000 (nearly 12,500 cases per year). Furthermore over the same period it processed 241,000 inquiries (80,000 per year). Among other things, in doing so, the Department assisted Pennsylvania citizens in recovering over \$3.6 million by compelling insurers to make refunds to affected blocks of policyholders. This also served as a forceful reminder to insurers and agents to comply with the insurance law in dealing with its customers. Similarly, during the last four or five years, the California Department of Insurance has taken action against admitted insurers that resulted in mass refunds of premiums of \$850,000 by an insurer to defrauded members of the public who had purchased policies of insurance by misrepresentation; the filing of an Accusation by the Department of Insurance against a life and disability carrier with the resulting mass refunds of \$300,000 to its policyholders and a complete revision of the company's claims practices were made, new auditing procedures were installed and refund of \$50,000 was made to its policyholders; and the filing of an action against an insurer for alleged fraud and misrepresentation in the sale of its products with the result that \$100,000 was made in restitution of moneys paid and also rescission was made to every person who purchased the company's product.

Smaller states are similarly very active. During 1970, the New Hampshire Insurance Department processed approximately 1,250 claim complaints thereby assisting the people of New Hampshire in recovering some \$306,000 in settlements. During the same period, pursuant to our very stringent law regarding the cancellation, nonrenewal, or refusal to write automobile insurance, we reviewed approximately 235 complaints. Early this summer we are going to implement the Oregon practice of sending department personnel around the state on a regular schedule to assist the public with its insurance inquiries or complaints.¹⁵ (Several larger states have permanent multiple offices to better serve their citizens.)

In 1969, the Missouri department received approximately 4,500 complaints. In Nebraska the scope is closer to 2,200. Of course many complaints prove to be invalid or no more than misunderstandings which are cleared up.

These illustrative facts demonstrate that state insurance departments serve as an effective local (and hence readily accessible) vehicle through which the insurance buying public can obtain effective redress. Furthermore, by proceeding through informal as well as formal administrative process, the consumer can seek relief at relatively little or no cost in time or money. Prompt

¹⁵ In February of this year the Oregon Department received 468 complaints, closed 486 complaints of which approximately 50% were valid and recovered \$29,500. On an annualized basis, this would translate into closing 4,800 cases and recovering \$350,000 which would be slightly more than the \$320,000 recovered last year.

results can be achieved without the necessity of long trials, rules of evidence, employment of counsel, etc.¹⁶

This is in marked contrast to class actions, which are notoriously slow-moving, which involve elaborate and protracted examinations before trial to secure the facts, and which utilize frequent consultations with the court and extended trials. Consequently, the lawyers' fees are apt to be very large. Months and sometimes years pass before some aggrieved customers obtain refunds, often a relatively small amount. By contrast, in complaints involving insurance companies, investigators paid by the state dig out the facts without cost to the complainant. No law suit is required and no lawyers need be employed, though the complainant may employ counsel if he so desires.¹⁷

Keeping in mind the extent of insurance department powers and the prompt, effective and inexpensive means of redress through the complaint procedure, on balance the exclusion of insurance would be sounder public policy.

7. Chaotic Three Part Insurance Regulation

The enactment of the current version of S. 984 or S. 1378 could lead to chaotic insurance regulation which, in turn, would impede the insurance industry in effectively serving the public. The insurance industry could be subjected to a three part regulatory scheme; (1) state regulation coordinated through the NAIC, (2) federal regulation both in terms of federal substantive law and enforcement procedures via the FTC and (3) judicial law stemming from court decisions in class action suits. None of the proposed bills provides for machinery to tie together the case law resulting from independent judicial actions and the regulatory activities to be conducted by the FTC with these activities of the states. If someone intentionally sets out to create anarchy in a regulatory system, a more effective vehicle is hard to imagine. The economic and social system of this nation cannot effectively function without orderly insurance markets regulated in an orderly way. We ask Congress to consider carefully before taking this legislative plunge.

C. SUMMARY AS TO THE MCCARRAN ACT PROBLEM

In short, for several reasons, the NAIC opposes the inclusion of "insurance services" in those federal class action bills which would pose a McCarran Act problem.

(1) Application of the federal government triggering concept to insurance could lead to an adverse effect on the carefully constructed balance between antitrust concepts and the complex system of insurance regulation.

(2) In the area of protecting the consumer against unfair trade practices, there already exists a detailed and comprehensive insurance regulatory mechanism at the state level paralleling that of the FTC.

(3) State insurance regulation provides a wide range of standards, powers, sanctions and remedies which go far beyond those available to the FTC.

(4) The intrusion of a federal regulatory agency would create a duplication and conflicts between state and federal law (both substantive and procedural) at an increased cost to taxpayers. Or, such intrusion might ultimately preempt this regulatory area thereby resulting in a more narrow, less protective system of regulation than that provided by the states.

(5) It would be poor public policy to interject the FTC into complex insurance regulation when it is currently overburdened, understaffed and subject to much unanswered criticism, especially when the field is already comprehensively covered at the state level.

(6) While the NAIC has taken no position for or against class actions, intense regulation on behalf of the consumer lessens the need for class actions. Furthermore, the states provide an effective, local, readily accessible

¹⁶ Of course, insurance department action is subject to judicial review.

¹⁷ If by any chance the commissioner does not act on the complaint—and such cases are very rare—the complainant can contact his state legislator or governor to act on the complaint. Furthermore, the company does business in more than one state, as is usually the case, the insurer knows that its handling of the case must be consistent and must command acceptance by the regulatory authorities in the other states in which it does business. With the availability of this simple, prompt, and inexpensive machinery, and with the existence of the system of checks and balances, it can be argued that expensive and slow-moving class actions would seem to be an expensive luxury in the already extensively regulated insurance business.

complaint mechanism and administrative relief to the consumer which serves as an alternative to class actions.

(7) The proposed legislation provides no means of coordinating FTC, federal court decisions and state insurance department activities. This, in turn, will lead to anarchy in regulation and, hence, diminished insurance industry effectiveness in serving the public need.

Accordingly, we submit that the deletion of "insurance services" by providing an express exemption would be in the consumer and public interest at this time.

Senator Moss. Mr. William Scott, general counsel of Scott Paper and representing the Grocery Manufacturers will be our next witness.

We are pleased to have you, Mr. Scott, and if you have associates you will introduce them when you start your testimony.

STATEMENT OF WILLIAM R. SCOTT, VICE PRESIDENT, LAW DIVISION, SCOTT PAPER COMPANY; ACCOMPANIED BY JONATHAN W. SLOAT, VICE PRESIDENT, GOVERNMENT RELATIONS, GROCERY MANUFACTURERS OF AMERICA, INC.

Mr. Scott. Mr. Chairman, at the outset I want to thank you for allowing me the privilege of appearing here. My associate is Mr. Jonathan W. Sloat, who is vice president for government relations of the Grocery Manufacturers of America, Inc.

Senator Moss. Mr. Sloat, we are glad to have you here.

Mr. Scott. My name, as you know, sir, is William R. Scott. I am vice president in charge of the law division of Scott Paper Co. I am appearing on behalf of the Grocery Manufacturers of America, a trade association of which my company is a member. This association represents manufacturers of food and nonfood products sold through grocery outlets.

My comments should take only a few minutes of your time. At the outset let me say that GMA and its members have always been interested in the welfare of consumers. As a matter of fact, the members of GMA are entirely dependent upon the consumer for their survival.

From the point of view of fair dealing, which is more important—and which our membership firmly believes in—the rights and welfare of the consumer must be recognized.

We are strongly in favor of legislation which will put a stop to practices which defraud the consumer. Last year GMA supported legislation to give the Federal Trade Commission power to go into court for preliminary injunctions.

GMA also supported a proposal to enlarge the jurisdiction of the FTC to cover matters that affect interstate commerce rather than only transactions actually in interstate commerce.

GMA continues to support these two pending proposals as providing prompt and effective remedies against consumer fraud.

We feel that prompt and effective redress for the consumer is also extremely important. Class actions, in our considered judgment, would not provide prompt and effective redress for the consumer.

During the last session of Congress three individuals made appearances on behalf of GMA in regard to class actions. Briefly

stated, GMA takes the position that class actions are not an effective remedy for the consumer and could result in harassment of legitimate business enterprises.

The points we made last year in support of this position are still valid today. In fact, they have been well made by other witnesses before this subcommittee during its hearings last year and this.

We see no need to take up the committee's time by repeating all of these points today. However, we do include for your reference a copy of an illustration that appeared in the GMA testimony last year. It presents graphically the complicated legal maze through which consumer plaintiffs would have to travel in order to attempt to achieve redress under the proposed class action bills.

There are two additional points we would like to emphasize. First, the amount of money involved in the purchase of a grocery item is very small. A witness testified last year that the average unit cost to the consumer of grocery products in the supermarket is 43 cents. In a class action suit involving a grocery product there would be serious question whether the individual members of the class, other than those actively involved in the action, would in fact take the trouble to apply for and receive the amount awarded in a judgment.

If that is true, then the attorney who brought the class action could receive a substantial fee based on the total recovery, whereas after possibly several years of litigation, no individual consumer would receive any substantial amount and many might receive nothing.

Second, as to harassment of business, it should be recognized that broad class action legislation could invite suits brought for the purpose of obtaining a settlement regardless of the merits of the claim on which the suit is based. A company may well settle a suit to which it has a complete defense simply because that is less expensive than trying and winning it.

GMA, therefore, continues its objections to class actions. However, regardless of whether this committee determines that class action or any other form of consumer legislation is desirable, GMA recommends that provision be made for an appropriate money back arrangement which would provide prompt and effective redress for the consumer.

Under such a provision anyone who felt aggrieved as a result of receiving faulty merchandise, poor service, or failure to fulfill any offer or other inducement made in connection with the purchase of goods or services, could receive at his option a refund of the purchase price for, or replacement of, the goods or services, or obtain fulfillment of any such offer or other inducement.

The most important aspect of a money back arrangement is the promptness with which the consumer would obtain redress. A collateral aspect would be the avoidance of litigation over the small amounts involved.

Appropriate legislation should provide that if a supplier has a bona fide, publicly announced, money back plan, a consumer seeking redress provided for in that plan must request such redress and fail to get it within a reasonable time before being entitled to bring an action for the same purpose.

I believe there has already been some testimony before this committee that distributors in the grocery industry generally provide a money back system, and that is apparently almost universal if not universal. And there is the risk that a class action provision may make people feel that if they give money back that that could be considered an admission in some later legal action.

The foregoing is simply a brief statement of the basic principle involved. If the committee looks with favor on the principle, GMA will be happy to present appropriate language for the statutory provision to cover the money back arrangement.

Senator Moss. Thank you very much, Mr. Scott.

Isn't a money back arrangement practiced quite widely now in grocery sales?

Mr. Scott. That is my understanding, sir, yes.

Senator Moss. And, of course, I couldn't agree more heartily that that is the swiftest and most favorable way for a consumer who is dissatisfied with his lot, to simply take it in and get his money back. I would have no problem at all in requiring it as a jurisdictional matter that it be alleged whether or not he made a demand and whether or not he was refused his money back.

I also am quite well persuaded on the size of the item. You said 43 cents was the testimony last year on the average item in a supermarket, and, as I recall, most of the bills have a monetary limit which is well above that with respect to the number of or the price of items to form a class. I could see the futility of having mass class action for items that cost 43 cents or even \$1 or perhaps even \$5. When you get up to \$5, maybe you are getting in the area where you are talking about the kind of thing that can be done appropriately in a class action case.

So, those are very much in the minds of the committee, subcommittee and committee, and I am sure will be given most serious consideration when we mark up a bill.

Your concern about the so-called strike suit does cause me more concern because I think careful reading of the bill will show you that litigation passes immediately under the jurisdiction of the judge when the action is filed, and the Federal judge, if this became the law, would then be in control. He could call a preliminary hearing, have the parties before him, and make a decision as to whether or not there was reasonable basis for bringing the suit. He could dismiss it right at that point or set up his pre-trial order as to the proof that would be required in there. And, if you refer to the bill, you will find that in the event that the judge finds that this is a frivolous or improperly brought suit, he may not only dismiss it—must, indeed, dismiss it—but he may then assess costs and attorneys' fees against the ones who brought the frivolous suit.

Now, do you think that is enough protection to assess against the so-called strike suits?

Mr. Scott. Well, I am a little concerned, sir, because in my experience I have found that a plaintiff may bring a suit, and if so, often brings it with an allegation of damages which are almost incredible in some cases, and will go on into the question of pretrial discovery, depositions and whatnot, and often it frankly is simpler

for a corporation to settle the case early, in the early stages rather than litigate for 3 or 4 years at a cost of maybe \$50,000 to \$100,000. I, personally, have seen that situation happen, sir.

Senator Moss. Would you think that, including language, that no settlement could be made without approval of the court would give any more protection on a strike-suit basis?

Mr. SCOTT. Offhand I would think that that might confuse the situation a little bit. I think that you then become involved in some of the early stages of the litigation in the form of depositions, pretrial discovery and whatnot, in order for the court to reach a conclusion.

You would still be involved—

Senator Moss. Don't you think, though, that would reveal to the court at that stage whether or not there was a bona fide action or whether it was one simply trying to maneuver a settlement or some lawyer's relief action?

Mr. SCOTT. I think it well might. On the other hand, I also think that a court is sometimes rather slow to put substantial costs and attorneys' fees on individual plaintiffs who obviously don't have the wherewithall to meet them.

Senator Moss. Well, it might not be as substantial as, perhaps, would be indicated; but nevertheless, it would be quite a deterrent effect, wouldn't it?

Mr. SCOTT. I think it has a deterrent effect.

Senator Moss. I suppose in just the fact that the courts are open there is a possibility, of course, of bringing a suit that is not fully justified and thereby trying to wrangle some kind of a settlement, a nuisance suit as we call it.

I just wonder if this increases the present danger that exists in the court by making it possible to bring it in a class.

Mr. SCOTT. I think, sir, the courts are already pretty overburdened. If we can believe not only what we know in our own immediate vicinity but what we read in the papers about the rest of the country and the pressures for the settlement of cases, and I think that very pressure makes some pressure on the defendant to settle the case and get it out of the courts.

Senator Moss. Well, that is so and might not a class action be a step, really, toward relieving the burden somewhat? Take, for instance, a \$20 toaster that was sold with a fault or a nuisance and after it had failed, the customers could not get their money back. They went to the appliance dealer and he said no. So they filed an action and there may have been, say, 10,000 toasters out. Now, if it is \$20 or \$25, that is probably enough to induce a good many of them to go to the small claims court in their city or someplace to try to get redress. So, you might have as many as 10,000 small actions filed, whereas if a class suit were available they might all be put together in one suit, and assuming they had a just claim for their money the whole thing could be settled in one action for the whole 10,000.

Now, in that case, that is an economy on the time of the court, isn't it?

Mr. SCOTT. I think it would be. I think, on the other hand, from my somewhat cursory review of the history of class actions, the question of determination of the class, the question of what kind

of notice has to be given and a lot of these questions are left to the courts. The results have been different from court to court in cases that have some similarity, and I frankly am concerned about not only the burden on industry raised by class actions, but the fact that I question whether they are really an effective remedy for the consumer from the standpoint of taking care of what is considered to be the entire class.

Senator Moss. Well, of course, under rule 23, we already do have class action, some class actions are authorized now. This would probably be an extension of that and perhaps we are hoping for the ideal basis of determining the class and service and so on. Perhaps that would become much more regular.

But, I appreciate your comments and your point of view and it is something that we are concerned with and we certainly don't want to move off in a field where we do not improve the situation for the supplier as well as the consumer. We need to protect all across the board.

Senator Hart, who is vice chairman of this committee, is here and maybe he has some questions.

Senator HART. No.

I apologize to Mr. Scott and you, Mr. Chairman, for arriving late. I do get the thrust of Mr. Scott's testimony.

Mr. Scott. Well, I am glad you were able to get here at all, sir. I know the burden you gentlemen operate under because there is a proliferation of problems before you, and I am very sympathetic and I appreciate the really serious and deliberate consideration you are giving to these problems.

Senator Moss. Thank you, Mr. Scott.

I made a little speech at the beginning about how diffused was our jurisdiction and where the members might be, and so we are glad you are here, Senator Hart.

Thank you very much, gentlemen. We appreciate your appearance and thank you.

Mr. Scott. Sir, may I ask one question? Would you like to have us submit actual language for the type of money-back provision we had in mind?

Senator Moss. We would appreciate that. If you would set it in language and send it to the committee, we certainly would like to consider it and you might point out where you think it might be inserted in the legislation, any one of the bills, so we could look at it.

Mr. Scott. We will certainly do that, sir, and thank you very much.

Senator Moss. Thank you.

(The following information was subsequently received for the record:)

GROCERY MANUFACTURERS OF AMERICA, INC.,
Washington, D.C., May 24, 1971.

Senator FRANK E. MOSS,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR MOSS: Enclosed for the record is language for a consumer money-back amendment to the class action proposals currently being considered by the Subcommittee on Consumers of the Senate Commerce Committee. This amendment was discussed in GMA's testimony, presented by William Scott,

Vice President of Scott Paper Company, in hearings before the Subcommittee on April 29, and is submitted pursuant to your request to Mr. Scott at that time.

We believe that a consumer money-back amendment would promote quick and efficient consumer satisfaction that would be applicable to literally hundreds of billions of consumer transactions per year. The concept of the consumer money-back amendment is simple, and based upon a long-standing practice of both the manufacturing and retail sectors of the grocery industry: if the consumer is dissatisfied with our products, we give the purchase price back to her. In short, "the customer is always right."

Such a business practice, based upon mutual trust between the consumer and the grocery industry, could be jeopardized seriously by the present class action proposals. The practice is based upon the assumption that few consumers will try to cheat, and therefore no or very few questions are to be asked when a consumer gets her money back. Such a return of money under any of the consumer class action bills, however, could be taken as an admission of liability and therefore lead to the instigation of a mass restitution suit which, even if the manufacturer were innocent, would be very expensive.

The enclosed amendment would encourage and institutionalize the consumer money-back practice in a manner consistent with all the current consumer class action proposals. It would be particularly consistent with those provisions in the bills which, evidencing concern for over-burdened courts and impatient customers, call for encouragement of private and informal settlement procedures.

The consumer money-back amendment would enhance private settlement provisions by promoting the best consumer redress system in existence. Basically, the amendment provides that if a consumer may obtain redress from a supplier who has a publicly announced consumer money-back plan, a claim under the Act for that same redress may not be brought unless the supplier fails within a reasonable time to provide the redress sought. The rest of the amendment is concerned with closing any loopholes which might be used by an unscrupulous supplier to avoid liability.

We would appreciate your favorable consideration of this provision as an addition to any class action proposal considered by the Committee, as well as any comments you might have on this amendment.

Sincerely,

GEORGE W. KOCH.

P.S.—Also enclosed is a copy of Bulletin #26 of the Manual for Complex and Multidistrict litigation, which contains analyses of recent decisions involving class action suits, which may be useful to the Committee, and which we therefore wish to submit for the record.

Enclosure:

MAY 20, 1971.

CONSUMER MONEY-BACK AMENDMENT TO THE CONSUMER CLASS ACTION ACT OF 1971

Insert in S 984: On page 8, add the following new section 103 and renumber the subsequent sections accordingly:

Insert in S 1222: On page 10, add the following new section 10 and renumber the subsequent sections accordingly:

Insert in S 1378: On page 10, add the following new section 14 and renumber the subsequent sections accordingly:

"CONSUMER MONEY-BACK PLANS

"Section — (a) Any supplier may provide, for the benefit of consumers dissatisfied with a product or service of the supplier, a voluntary settlement procedure in the form of a consumer money-back plan that is bona fide, fair and reasonable as provided in this section.

(b) To be bona fide, fair and reasonable for the purposes of this Act, a consumer money-back plan shall

(1) provide for relief or redress in the form of a refund of the purchase price paid for goods or services (or, at the consumer's option, replacement of such goods or services) and the fulfillment of any offer or other inducement made in connection with the purchase of such goods or services to the extent that the consumer claims such offer or other inducement has not been fulfilled;

- (2) provide for public announcement, in a manner reasonably calculated to inform consumers, of the availability of such relief or redress;
 - (3) place no unreasonable burden on consumers; and
 - (4) be established in good faith and not used as part of a course of conduct to defraud consumers.
- (c) It shall not constitute an unreasonable burden on consumers for a consumer money-back plan to require, as a condition to furnishing relief or redress, that

- (1) where practicable, the goods be returned;
 - (2) where practicable, evidence of purchase can be presented;
- or that
- (3) consumers state their reason or reasons for seeking relief or redress.
- (d) A claim for relief or redress shall not be entertained in any action under this Act by or on behalf of one or more consumers against a supplier who has a bona fide, fair and reasonable consumer money-back plan under which the relief or redress sought in such action may be obtained; *provided, however*, that this subsection (d) shall not prevent a claim for relief or redress in an action by or on behalf of one or more consumers where such consumer or consumers have requested in writing and failed to receive, within a reasonable time, the relief provided for in accordance with the supplier's consumer money-back plan."

MANUAL FOR COMPLEX AND MULTIDISTRICT LITIGATION,
THE FEDERAL JUDICIAL CENTER,
Washington, D.C., April 23, 1971.

BULLETIN No. 26, SECOND CLASS ACTION SPECIAL—To ALL JUDGES CONCERNED
WITH COMPLEX AND MULTIDISTRICT LITIGATION

The following recent decisions appear to be of special interest to judges involved in complex class action litigation. As these decisions have been collected and summarized by the editorial staff*, their inclusion does not mean that the Board of Editors approves of the procedures used or the results reached in any particular case.

AGGREGATION OF DAMAGES

Cashman v. Port of New York Authority, 319 F. Supp. 1264 (S.D. N.Y. 1970)
Judge Lasker

Plaintiffs sued "on behalf of themselves and all other retired members of the police force of the Port of New York Authority." Plaintiffs sought an order establishing this action as a class action and defendant moved to dismiss it for failure to satisfy the jurisdictional amount.

Plaintiffs claimed that defendant breached a contract whereby it promised to pay all Port Authority police officers a pension equal to one-half of their average annual salary for the five consecutive years in which their earnings were the highest. This action is for the difference between the annual retirement benefits they have received and the amount they were allegedly entitled to receive. This amount varies from \$173 to \$2,320, and no plaintiff has a past deficiency or an actuarially-computed total life deficiency of more than \$10,000.

The court dismissed the action, holding that, under *Snyder v. Harris*, the plaintiffs' claims were separate and distinct and therefore could not be aggregated to meet the \$10,000 jurisdictional amount rather than *joint and common* claims where aggregation is permitted.

STANDING TO BRING CLASS ACTION

Cordova v. Bache & Co., Inc., 321 F. Supp. 600 (S.D.N.Y. 1970) Judge Mansfield

Some 42 leading brokerage firms and the New York Stock Exchange were charged with conspiracy to restrain trade by reducing commissions paid to securities representatives employed by them in violation of the Sherman Act. Plaintiff Cordova, president of the American Association of Securities Repre-

*The Editor wishes to thank Mr. Jon Paugh, Administrative Attorney for the Judicial Panel on Multidistrict Litigation for his assistance in preparing this bulletin.

sentatives (composed of more than 5,000 securities representatives), sued on behalf of himself, the Association, and all other present and future securities representatives similarly situated. Defendants moved to dismiss.

Plaintiff did not allege that he himself was employed as a securities representative nor did he claim that his or the Association's property, business or earnings had been adversely affected by the alleged conduct of the defendants. Having no stake in the outcome, the court concluded that plaintiff lacked standing to assert an antitrust claim under the Clayton Act. Further, the court held that the fact that plaintiff sued on behalf of and as President of the Association did not provide him with standing since the Association itself had no standing to assert the rights of its members under the antitrust laws.

However, plaintiff requested and was allowed to substitute as plaintiffs several individual securities representatives and the court then rejected defendant's motion that the complaint failed to state a claim upon which relief could be granted.

CONSUMER CLASS—REPRESENTATION, MANAGEABILITY AND NOTICE

In re Coordinated Pretrial Proceedings in Antibiotic Antitrust Actions, (S.D. N.Y. Feb. 10, 1971) Judge Miles Lord

The seven states, which refused the defendants' settlement offer, sought to represent classes composed of all retail purchasers of antibiotic drugs for human consumption within their jurisdictions. The court concluded that plaintiffs had made a sufficient showing to warrant the establishment of the proposed classes, but delayed giving notice to the class members until the court was satisfied that the actions were manageable and that the absent members of the class could be given adequate notice.

The proposed class clearly satisfied the requirements of Rule 23(a).

And the court also found that the questions of defendants' violation of the antitrust laws and "the fact of damage" to the class were "common." The court also expressed its tentative conclusion that the amount of damages to the plaintiff class might also be litigated through representative parties under Rule 23. The court observed that it was far simpler to prove the amount of damages to the members of the class by establishing the total damages than by collecting and aggregating individual damage claims. The court was of the opinion this could be done without sacrificing the rights of the defendants.

The court rejected the defendants' argument that Rule 23 required each class member to come forward with his claim prior to trial, observing that it would be better to defer the filing of "proof of claim" forms by individual members of the classes until after the cases had gone to trial and judgment entered. The court was unwilling to impose the expense and burden of such a requirement on absent members of the classes at this preliminary state.

Many of the qualifications listed in Rule 23(b)(3) for determining the "superiority" of the class action were satisfied. The individual members of the class had little, if any, interest in maintaining separate actions; the claims were large in the aggregate but small on an individual basis; and common questions were so predominant that an individual class member could have little objection to his representation by a competent plaintiff.

The final issue faced by the court was whether the difficulties in management of these actions precluded the finding that the class action was "superior to other available methods for the fair and efficient adjudication of the controversy." The court stated that this perspective was particularly important where the defendants, after reciting potential manageability problems, seemed to conclude that no remedy was better than an imperfect one. Although its tentative conclusions concerning trial of the damage issue eased the manageability problem somewhat, the court was cognizant of the language of the *Eisen Case*. It required the plaintiffs to demonstrate further that the actions were sufficiently manageable and that satisfactory notice was possible. The court required the plaintiffs to answer the following specific questions directed to these issues:

- (1) The approximate size of the class each plaintiff seeks to represent and the manner in which that size was determined.
- (2) Any *factual* information they deem relevant to the determination of manageability;
- (3) Any proposals for limiting the size or increasing the manageability of the classes;

(4) How, in general outline, these cases should be administered, from the present date through the award of damages to the class and the processing and payment of individual class members' claims;

(5) Whether subclasses should be designated and, if so, on what basis and by whom represented;

(6) A specific itemization of all costs which the plaintiffs can reasonably expect to incur (including attorney's fees) in the prosecution of this case from the damages awarded the class.

(7) A specific itemization of any other expenses which might reasonably be incurred by plaintiffs' class in proving their case and damages;

(8) An itemized approximation of the expenses which might reasonably be expected to be incurred by the "average" member of the plaintiffs' class in submitting his claim under the plaintiffs' proposed procedure;

(9) An itemized approximation of how much in damages the "average" member of the plaintiffs' class might reasonably be expected to ultimately prove;

(10) As a matter of law and practice, at what point or points in the course of this case notice should be sent to the members of the class;

(11) Proposed means of notifying the other members of the class at each point in the course of this case where notice, if appropriate, together with an itemization of the cost of each notice;

(12) What type of notice is required in these cases to give other members of the plaintiffs' class notice consistent with Rule 23 and the due process clause;

(13) How much of the cost of preparing and communicating the notice each plaintiff would be prepared to bear;

(14) Any other information relevant to the issues implied by the foregoing which plaintiffs desire to bring to the attention of the court.

Eisen v. Carlisle & Jacquelin (S.D. N.Y., April 7, 1971) (Judge Tyler)

Although the Court of Appeals determined that certain of the requirements of Rule 23 were satisfied in this action, the District Court, following remand, was still faced with questions concerning adequacy of representation and manageability of a class composed of approximately six million members.

As to the adequacy of the representation of the class by plaintiff's counsel (a sole petitioner), the Court had "no hesitation" in ruling that plaintiff's counsel had satisfied all requirements.

The Court noted that the issue of *manageability*, while only one of many factors to be considered under Rule 23, "assumes major proportions" in a case of the size and nature of this one. The Court then determined "that gross damages may be fairly estimated without having individual claims filed by each class member." The Court went on to calculate the cost of "c-2 notice" (including printing and mailing and publication) to be about \$500,000 compared to treble damages of at least \$22,000,000 if plaintiff is successful thus pointing to a potentially substantial *net* distribution to the class. The Court indicated it would consider a "fluid class recovery" with possible distribution to the class as a whole rather than to individual class members.

The Court decided that a combined direct mailing and publication notice should be used with individual notices going to about 2,000 class members involved in ten or more odd-lot transactions and to 5,000 other class members selected at random from the two million identifiable members of the class. A notice is to be published (twice) in the *Wall Street Journal* and four metropolitan daily newspapers. In order to gain more information about the nature of the class, the mailed notices will include a request for certain *transaction* information. Responses will be *voluntary* and will not affect the individual's right to be a member of the class.

The question of who should bear the cost of the notice—the representative plaintiff or the defendants—became an extremely important one for the plaintiff indicated it could not afford to pay for the notice required by the Court. But before deciding how to apportion the cost of notice, where the plaintiff cannot pay, the Court concluded it should hold a preliminary hearing on the merits similar to a hearing on a preliminary injunction. The Court reasoned that plaintiffs must make a strong showing of likelihood of success at trial on the merits before it would burden the defendants with the cost of the "c-2 notice."

SIZE—IMPRACTICALITY OF JOINDER

Cash v. Swifton Land Corporation, (6th Cir., Dec. 4, 1970) Judge Celebrezze

This is an appeal from an order of the district court dismissing plaintiff's complaint against defendant, an owner of a large apartment complex. The action was brought under the Fair Housing Act to forbid defendant from refusing, on racial grounds, to rent a vacant apartment to the plaintiffs and to enjoin the defendant from refusing to rent vacant apartments to "all similarly situated Negro Citizens" who apply for them in the future. Subsequently the plaintiffs were offered, and accepted, the apartment for which they had applied, without prejudice to their right to pursue the lawsuit. The district court, on its own motion, ordered the complaint dismissed as moot and for failure to state a proper class action.

The appellate court upheld the lower court's dismissal on the ground that except for the named family, plaintiffs were unable to state that there were others "similarly situated" with them. The court noted that although mere numbers are not determinative, the plaintiff in a purported class action has the burden of showing that the circumstances surrounding the case justify a determination that the number is so large that it would be impractical to join all the parties.

The case was remanded for determination as to whether or not damages should be awarded.

Landsdale v. Tyler Jr. College, 318 F. Supp. 529 (E.D. Tex. 1970) Judge Justice

The plaintiff sought to represent a class composed of all persons who were denied admission to Tyler Jr. College because of the school's dress and grooming requirements. The court found that there were about forty students who were denied admission and an unknown number who made no effort to register because of their knowledge of and opposition to the hair styling regulations of the school. The court concluded that joinder of the members of the class was impractical and the class was approved.

NOTICE

In re Coordinated Pretrial Proceedings in Antibiotic Antitrust Actions, (S.D. N.Y., Feb. 9, 1971) Judge Miles Lord

The seven states which rejected the defendants' settlement offer sought to represent classes composed of each state and all government entities within the state which purchased broad spectrum antibiotics from the defendants.

The court allowed the classes to be maintained under Rule 23(b)(3). It concluded that the members of the proposed classes were sufficiently numerous that joinder was impracticable and that the claims of the states were typical of the classes and that the attorneys general were natural representatives of the class.

The court also found that questions concerning defendants' violation of the antitrust laws and "the fact of damage" were common to the class and predominated over individual questions. The superiority of the class action as a means of recovering on behalf of the individual members of the government entity classes was also established. Any management difficulties to be encountered were thought to be far exceeded by the administrative difficulties which would result from separate trials.

Because the members of these classes were relatively few in number, and identifiable, the court required the (c)(2) Notice to be given by mail and that a "proof of claim form" be included with the notice. The notice informed the class that if they did not opt-out, their claims would be barred *unless* they completed and returned the proof of claim form within the prescribed time. The court noted that such a requirement was reasonable where the members of the class were readily identifiable, their purchases easily ascertainable, and their individual claims large enough to justify the expense of the procedure.

Abulaban v. R. W. Pressrich & Co., (S.D. N.Y., Feb. 5, 1971), Judge Metzner

The district court permitted this action to be maintained as a class action and defendants urged that because of the possible liability of the class to the defendants on their counterclaim, class members should be required to "opt-in" rather than to "opt-out".

The court observed that in several cases the class action notice included a requirement that class members file a proof of claim form in order to become a class member. These cases involved potentially large classes, where such

information aided in reappraisals of the class action determination and preparations for trial. The court felt that such requirements were more relevant to questions of pretrial discovery and concluded that failure to file an inclusionary request should not preclude a person from being considered a member of the class.

In any event, the plaintiffs' class consisted of an approximate 200 persons located in Kuwait whose names and addresses were known by the defendant; many of whom had retained plaintiffs' counsel. The possibility of an unwilling class member becoming bound by a judgment of liability to defendant seemed remote and the court saw no reason to include a reference to defendants' third-party proceedings in the (c) (2) notice.

SETTLEMENT

State of West Virginia v. Chas. Pfizer & Co., Inc., — F.2d — (2nc. Cir., Mar. 29, 1971) Judge Smith

This is an appeal from an order of Judge Inzer B. Wyatt (Bulletin No. 22, page 8), approving the settlement in these cases and dismissing those actions.

The court observed initially that it is "well settled that in reviewing the appropriations of the settlement approval, the appellate court should only intervene upon a clear showing that the trial court was guilty of an abuse of discretion." The court then observed that the "pass-on defense" might have been available to establish that the "wholesaler-retailers" passed-on the overcharges to their customers and therefore were not damaged by the overcharge. The court concluded that the district court has properly considered this possibility in approving the settlement as to wholesaler-retailers.

That court then went on to hold that these actions were properly maintained as class actions under Rule 23(b) (3) although it added that "the court below might well have considered making use of a *parens patriae* theory in the present case." The court also concluded that the notice by publication as used here was adequate to meet the due process problems. The one aspect of the manner in which the consumer class recovery was handled which presented some difficulty was the procedure whereby the states were allowed to recover on behalf of the class without requiring any affirmative indication from individual members that they wanted to assign their claims to the attorney general. While noting that there were some cases in which courts have required class members to give notice that they wish to participate, the Second Circuit concluded that the procedure used here was acceptable. The other points raised by the appellants appeared to be without merit and were dealt with summarily.

See, also *Schwartzman v. Tenneco Manufacturing Co.*, 319 F. Supp. 1278, (D. Del., 1970) Judge Latchum

RES JUDICATA EFFECT

In re Antibiotic Drug Antitrust Actions—Richard X. Connors v. Chas. Pfizer & Co., Inc. (S.D. N.Y. April 6, 1971) Judge Miles Lord

The defendants moved to dismiss this action on the ground that all six plaintiffs were included in one of the so-called "settling-cases" (the Commonwealth of Virginia class action) and were therefore barred by the judgment (dismissal upon settlement) in that class action. This action was commenced after the notice to the members of the Virginia class action was given by publication and it was undisputed that none of the six plaintiffs "opted-out" of the Virginia class action or filed a statement of claim as required by the class action notice. They contend, however, that they were not bound by the judgment in the Virginia class action on the ground that the manner by which the settlement offer was made, accepted, and approved violated the constitutionally protected rights of absent class members. They specifically contend that the (c) (2) notice and the (e) notice were both defective, that the class representative (the attorney general) had an adverse interest and that a disproportionate share of the settlement was distributed to the Commonwealth and its political subdivisions.

The court found that these six plaintiffs were fully and fairly represented by their attorney, that the hearings held in connection with the proposed settlement and that they were therefore bound by the judgment in the Virginia class action, subject of course, to attack by direct appeal to the appropriate court. Defendants' motion was granted and the action was dismissed with prejudice.

Pasquier v. Tarr, 318 F. Supp. 1350 (E.D. La. 1970) Judge Comiskey

The plaintiff is a young father who received a II-S graduate student deferment but was then refused a III-A fatherhood deferment. In this action he claims he is entitled to summary judgment because he is a member of the class defined in *Gregory v. Hershey*, 311 F. Supp. 1 (E.D. Mich., 1969). That court entered a judgment in favor of the class holding the selective service regulations which denied III-A status to anyone who held a II-S graduate deferment void and unenforceable. Plaintiff contends that since he is undeniably a member of the *Gregory* class, the court is bound by the decision in that case.

The court disagreed and held that the failure of the Michigan Court to give notice to the members of the *Gregory* Class constituted a violation of due process and precluded the judgment in that case from having *res judicate* effect either for or against the members of the class.

The court recognized that there was some dispute as to whether notice is required under Rule 23(b) (2) but it decided to follow the Second Circuit's opinion in *Eisen v. Carlisle & Jacquelin*, which holds that such a notice is required as a matter of due process in all class actions under Rule 23. The fact that the absent class member was not the one objecting to the lack of notice was immaterial for the court believed that the matter had to be viewed from both sides: To allow an absent class member the benefit of a favorable class action judgment which lacks due process without binding him with unfavorable judgment would be fundamentally unfair in that it would give "absent members of the class two bites at the apple at the expense of the defendant."

The court emphasized that it was not ruling on what type of notice the Court should give to absent members of a (b) (1) or (b) (2) class but held "only that the absolute failure to give any kind of notice violates due process and that . . . (it was) not bound by the holding in *Gregory v. Hershey*." [The court went on to hold that the II-A fatherhood deferment is a discretionary rather than a mandatory classification and could not be attacked prior to induction. The defendant's motion for summary judgment was granted.]

Whitmore v. Tarr, 318 F. Supp. 1279 (D. Neb. 1970) Judge Urbom

The Nebraska federal court faced the same issue described above and reached the opposite result. It was indicated that it would not question the validity of the finding of the court in *Gregory* that that action could be maintained as a class action. Although it had serious doubts that the *Gregory* Court had jurisdiction over the subject matter, it felt that it was not free to declare that the *Gregory* court had no jurisdiction nor could it declare that it did not have the power to enforce the judgment entered in the *Gregory* Case. Although noting its disagreement with the finding of jurisdiction in the *Gregory* case, the court declined to retry the issue of subject matter jurisdiction.

The court by finding that the question of propriety of the class suit and jurisdiction of the Michigan court had previously been litigated and there being no dispute that the plaintiff was a member of the *Gregory* class, concluded that the defendants should be bound by the prior judgment by the principle of *res judicata*. The court held that the judgment in the *Gregory* class action was entitled to full force and effect and the court directed that an appropriate order be entered granting relief to the plaintiff.

Copies of unpublished opinions may be obtained from the authoring judge or from the undersigned. Your suggestions and comments concerning the content and format of these bulletins are most welcome as are copies of opinions and orders which may be appropriate for inclusion in a future bulletin.

Very truly yours,

THE BOARD OF EDITORS FOR THE
MANUAL FOR COMPLEX AND MULTI-
DISTRICT LITIGATION,
JOHN T. McDERMOTT,

Executive Editor.

BOARD BULLETIN NO. 26.—CITATION LIST

Bulletin No.	Page	Caption	Citation
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24.....	2	Rogers v. Ray Gardner Flying Service, Inc.....	435 F.2d 1389, certiorari denied 39 LW 3437.
25.....	3A	Continental-Wirt Electronics Corp. v. Corning Glass Works, Inc.....	321 F. Supp. 981.

Senator Moss. Mr. Irving Scher, representing the Chamber of Commerce of the United States.

Mr. Scher is an attorney for New York City, a member of the firm of Weil, Weil, Gotshal and——

Mr. SCHER. It is Weil, Gotshal & Manges. There is an extra "Weil" in the witness list.

Senator Moss. I see.

STATEMENT OF IRVING SCHER, MEMBER, CONSUMER ISSUES COMMITTEE, U.S. CHAMBER OF COMMERCE; ACCOMPANIED BY KENNETH F. STINGER, STAFF ATTORNEY

Mr. SCHER. Mr. Chairman, Senator Hart, I am privileged to appear before you today on behalf of the National Chamber as a member of its Consumer Issues Committee.

Accompanying me is Kenneth F. Stinger, staff attorney for the Chamber's Consumer Issues Committee.

We have submitted our testimony, and I will merely highlight the testimony this morning.

Senator Moss. All right.

Mr. SCHER. Last year a representative of the National Chamber testified before this subcommittee on the important issue before you again today. In that testimony the National Chamber recognized the need for more meaningful forms of consumer redress and, in particular, more efficient means to handle consumer complaints promptly and effectively. But, the Chamber, as well as the other representatives of the business community who testified in the 91st Congress, opposed consumer class actions as not presenting a viable solution.

Now, considerable testimony has been presented in connection with a number of arguments in support of this contention, and I will not rehash them this morning because somewhat lost in the testimony are a number of facts which I would like to highlight.

For example, for the most common types of consumer complaints, class actions offer absolutely no promise of relief. Indeed, that was recognized this month in Consumer Reports.

Most common consumer complaints involve such problems as poor product performance, poor quality merchandise, service inadequacies, billing errors, and late or lost deliveries.

Now, these matters totally lack the commonality required for class actions under rule 23 of the Federal Rules of Civil Procedure. They typically involve one consumer or a few consumers and one supplier. Possible solutions to this kind of problem are being studied right now by the National Institute for Consumer Justice. These would include more efficient and effective small claims courts, neighborhood courts, more efficient individual and industry-wide voluntary settlement mechanisms such as the one presented to you just a few moments ago by TMA, binding consumer arbitration and improved State and local enforcement agencies, because they are mainly local problems.

In most instances all that may be required is direction of a complaint to the proper person in the supplier's organization who can help the consumer out.

Hard-core fraud, as has been testified time and time again, will also rarely be tested in class actions brought by the private attorney. This is because most private practitioners wouldn't consider it worth while to undertake such a suit against the kind of company that engages in hard-core kinds of fraud such as bait and switch, fraudulent referral schemes, or unconscionable markups. They are, again, local and typically perpetrated by the here-today, gone-tomorrow kind of company that hits an area quickly and disappears.

What is needed to combat hard-core fraud is strengthened governmental enforcement, including preliminary injunction powers, stronger civil penalties and perhaps even stronger criminal penalties.

Where real consumer abuse is involved causing serious financial harm, provisions for restitution, rescission of contract and negation of unexecuted consumer obligations should be considered.

The point is that there is a wide variety of instruments to consider in seeking to control undesirable behavior affecting the consumer. The approach suitable for one problem may be totally inappropriate for another. The question to be asked in each instance is which method promises the swiftest, most efficient remedy for the harm being claimed.

Where, then, will consumer class actions be generally used? The experience is already at hand in connection with the Federal Truth In Lending Act, which is the first Federal statute that specifically provides for both governmental and consumer relief.

Acting in the public interest, the FTC has successfully brought actions against companies operating in low-income areas. On the other hand, with no public interest to protect, virtually all of the private cases have been class actions against major national corporations and have involved, at least so far as we can tell from the complaints, subtechnical matters such as failure to use precise words required by the statute although all of the necessary information has been imparted.

Now, the truth in lending experience may serve as a guide to what may result from broadly defined class action bills now under consideration. The list of infractions encompasses virtually the myriad of practices prohibited by section 5 of the Federal Trade Commission Act. Indeed, S. 984 goes one step further and actually includes all such practices.

Most section 5 violations do not substantially harm individual consumers. In fact, harm is not required for a violation of section 5. The statute is not a fraud law but, instead, prohibits practices which may tend to deceive. Typical violations involve such advertising practices as claiming that a sewing machine is an "automatic zig-zag" when it should be designated just "zig-zag;" labeling a "split leather" belt as "leather;" or failing to note in an advertisement that custom jewelry is made in Japan, even though the package and product make such a disclosure.

Thousands upon thousands of such advertising and labeling practices have been challenged by the FTC and prohibited under section 5, and while there is a legitimate role for the government in controlling such practices, Congress should not establish private causes of action with mass recovery when, at best, the financial harm to the consumer is speculative.

The subcommittee should not labor under the delusion that class actions will not be instituted in such cases or quickly be disclosed. *Hall v. Coburn* was a New York class action involving only the legality of the type size used in installment contracts. The case was litigated for years before it was finally dismissed by the highest court of the State of New York last year as being unwarranted and not in furtherance of any public need.

Another area in which the FTC has become very active recently is an area seeking to establish new principles of law in cases dealing with television problems such as over-glamorized commercials, demonstrations exaggerating or not actually proving what is, in fact, a valid claim, advertising unique claims for products but failing to disclose nonunique factors as well, and substantiating a claim in a manner in which the Commission contends is insufficient.

Now, in these cases the Federal Trade Commission is seeking to deal with developing marketing concepts and to fashion new remedies. But it has been proceeding very carefully even though its cease and desist orders have but prospective application.

Moreover, the Commission is determining the form and extent of relief to seek on the basis of such factors as the dominance of the company involved, the nature of the wrong, and the extent and type of consumer injury or competitive harm.

These are all public interest determinations, in contrast to those which motivate an attorney's decision to institute a class action. However, the bills before this committee would permit class action in these cases involving over 100 million television viewers in each instance.

It would be both unwise and unfair to expose businessmen to long and expensive litigation involving massive classes of plaintiffs in connection with unarticulated principles of law.

The courts could react with overly restrictive interpretations of statutory terms which were intended by Congress to allow for expansive treatment by Federal agencies. Now, much has been said about the intolerable burden that consumer class actions would place upon courts due to the complex nature of such cases. Recent decisions demonstrate vividly the truth of such contentions.

For example, it can not be said that rule 23 in the Federal rules provides such protections against unwarranted or unmanageable class actions, or that such actions can be dismissed early in the proceeding. An attempt by a very fine Federal judge to grant summary judgment dismissing, under rule 23, what he believed to be a frivolous class action, a derivative stockholders' suit, was reversed just a few months ago by the Second Circuit Court of Appeals as being too hasty because the circuit courts really do not like summary dismissal of cases.

The case was quite interesting because the court didn't even attempt to dismiss the action until the conclusion of discovery proceedings involving more than 7,600 pages of documents, 12 sets of interrogatories covering 357 categories of information, 14 sessions of depositions encompassing 1,500 pages of transcript and 12 hearings.

As to the protracted nature of class actions, the first real consumer class action instituted under the antitrust laws in 1966, right after rule 23 was amended, is still pending before the trial judge.

That is *Eisen v. Carlisle and Jacquelin*.

Earlier this month, on April 7, the court finally ruled that a class action was appropriate. But, it also ruled that day, 5 years after institution of the case, that it could not determine yet who should pay for the notice to the 3,750,000 members of the class which was started by one consumer, by the way, with a \$70 claim. It took 5 years for the court even to begin to work out the mechanism of notice to the prospective class, which will be accomplished at an estimated cost of half a million dollars, even though it will involve personal notice to but 2,000 members of the class. And *Eisen* is one of the few cases to which any judicial experience could be considered because, as of now, not one class action has been fully litigated under amended rule 23 of 1966.

This subcommittee is considering three bills which attempt to come to grips with the perplexing problems inherent in class action litigation. But, the bills do not accomplish the objectives being sought. Each contains defects that demonstrate the basic difficulty in trying to apply one form of remedy to all consumer ills.

In particular, they do not deal adequately with four basic problems.

First, defining the class action subject matter. S. 984 would permit class actions for each and every act or practice prohibited by section 5 of the Federal Trade Commission Act. S. 137 would include any practice which gives rise to civil liability under state law for the benefit of consumers.

Such provisions eliminate any measure of predictability under classes which may create class action liability. Nor are they linked to any demonstrated consumer need.

Even the "laundry lists" contained in all three bills are too broad and vague. For example, just one item in the list would allow class actions against all misleading statements concerning a product's performance, uses or benefits. This would cover virtually every possible product claim.

A greater measure of predictability might be achieved by assigning a role to the FTC. The Commission could be authorized to conduct hearings designed to establish whether a particular practice is subject to misuse in a manner substantially injurious to many consumers. If this is determined to be a fact, a detailed and specific rule dealing with the problem could be issued and become a subject for class actions against those involved in the prohibited practice after the effective date of the rule.

This type of procedure is in fact dealt with in section 3(a)(5) of S. 1378, but, unfortunately, in addition to, rather than in lieu of the provisions establishing overly broad categories of practices subject to class actions.

Second, although all three bills recognize the need to administer class actions in a manner facilitating voluntary settlement, none really accommodates settlement procedures satisfactorily. Only S. 1378, seeks to avoid litigation entirely through prelitigation settlement techniques. But even this provision requires substantial revision, would require the supplier to identify each member of the class rather than exert a good faith effort to identify all such members.

It also allows for too short a period of settlement and has other problems as well.

All three bills purport to encourage settlement during pendency of class actions, but none allows the court to adopt a reasonable settlement offer as judgment in the case. Such a modification is essential because I think the case law bears out that rule 23 does not provide judges with sufficient control over litigation.

Third is weeding out improper suits. There are a number of ways to protect businessmen and courts against frivolous and unwarranted class actions. For example, S. 1222 provides that class actions can only be brought after successful government action.

Should the subcommittee determine that institution of class actions should not await some form of the governmental approval, every effort should be made to provide the court with as much authority as possible to deter and dismiss unwarranted suits.

A number of devices can be considered in order to assist the court in performing the essential role as protector of the public interest, a role that the plaintiff's attorney does not have.

For example, although section 12 of S. 1378 provides the court with discretion as to the party required to pay the costs of the initial notice to the class, it does not require an early hearing in order to resolve this question. Nor does it require such an early hearing to determine whether the claims are of such a nature that a bond should be required of the plaintiff, as is already provided for in rule 23 for derivative class actions.

The court could also be permitted, where appropriate, to serve notice after such an early hearing that the plaintiffs may be assessed costs or attorneys' fees if unsuccessful.

The fourth problem is Federal-State relationships. Congress must be very careful not to construct Federal causes of action which will swallow up typical State court matters of a local nature.

A statutory formula should be devised for a sensible allocation of matters between Federal and State courts. There is an attempt in this direction in sections 5 and 6 of S. 1378. However, these provisions do not provide for exclusive jurisdiction of matters involving local citizens in the State courts and exclusive jurisdiction to the Federal courts of matters involving multistate classes of plaintiffs.

On behalf of the national chamber, I am grateful for the subcommittee's attention and consideration of these views.

Senator Moss. Thank you, Mr. Scher, for presenting that statement of the chamber. They were before us last year. In fact, I appeared on a panel for the chamber with three other gentlemen in which we discussed the class action bill at some length. It was a very well attended session, I might say.

I do not know whether it is the result of the appearance down there, but on Wednesday on Washington Dial, which is a legislature information service of the U.S. Chamber of Commerce, there was a message put on about class actions. I was not able to get the full text of it, but I do have a partial quote of what was put on. Anybody that dialed that number got this sort of a message which was on yesterday, Wednesday.

I quote:

A great danger is that the class action suits would be directed at legitimate businesses based on their ability to pay large damages rather than on their guilt. In many cases, the filing of a class suit would amount to legal blackmail against a legitimate firm. The cost of fighting an extended legal battle and the damage a company could suffer in public relations even if innocent might compel it to agree to some kind of monetary settlement with leaders of the special interest groups as the lesser of the two evils.

In many cases, whether the business loses the case or makes a settlement, it will be the lawyers who benefit most and not the consumers.

The business community is joined in its opposition to class action legislation by prominent jurists who are alarmed that it would further burden the Federal court system with thousands of harassing suits against businesses, instigated in many cases by special interests in search of personal gain. Even Chief Justice Burger of the Supreme Court has warned of the dangers of the nationwide class.

That is as far as I was able to get the quote. I would ask you to furnish a full text of that message on the Washington Dial so that we can place it in the record. But, I would point out that this is the type of scare tactic being used in this city at the very time we are trying to sit here and collect evidence from various responsible people about a piece of legislation that is before us. What we want to know are specifics.

Now, you suggested some places that you thought the bills ought to be changed. We are glad to have your suggestions. We would welcome you submitting language to us that you think would accomplish a better purpose. But, to send out widecast over the city this kind of scare tactic sets up a situation in which the committee cannot be objective as we try to be, and we want to be objective.

I might point out that I have a little familiarity with Justice Burger's speech in which he said that the Federal courts were undermanned and they needed more personnel, that their case load was great. He was pleading for more support for the Federal judiciary. Among other things, he mentioned that class action cases, along with many other cases, were coming in the Federal courts and that they, because of lack of personnel, were not able to handle them as expeditiously as they should be handled. But, he did not single out that it was just the class action cases that were going to burden Federal courts with thousands of harassing suits.

I think this telephone message indicates an emotional opposition to this legislation rather than objective and reasonable opposition, and I do not think that it is worthy of the U.S. Chamber of Commerce, to put that kind of broadcast onto the telephone, Washington Dial, for anybody who wants to dial up to get it.

Now, these bills before us, I am sure, are not perfect, any one of the three, and maybe they still have not met their time. But, nevertheless, there is an insistent demand for some kind of relief to be pursued by consumers who cannot be served by the FTC because of its limitations of size and money and who are not at this time able to have a forum in which they can have their case properly presented. That is what we are seeking for. We are trying to find a way to do it without putting a burden, an unfair or unnecessary burden, on the producer and the seller. And maybe the class action bill needs to be changed.

I indicated earlier I thought, perhaps, there ought to be a money-back requirement to have jurisdiction, or some such thing as that.

Nonetheless, I am very concerned to have this kind of emotional and sort of a pressure-type thing being utilized in this city right when we are trying to sit down and hear facts of a case.

I recognize you represent the Chamber of Commerce. You are probably not the policymaker down there, but you are the man in front of us and I would like you to not only submit the full language of that, but any kind of statement that the chamber would like to officially make about putting that on at this particular time.

Mr. SCHER. Mr. Chairman, I will ask Mr. Stinger to search out that statement and submit it if it was made by the chamber. I, of course, as a private practitioner and member of the Consumer Issues Committee, presented this morning testimony which I prepared in which I believe. I have tried to avoid any appeal to emotions, to be objective, and to present only reasoned arguments. Additionally, I presented some thoughts about possible amendments to these bills.

I am certain that the chamber will be pleased to present amendments along the lines of those I mentioned in the latter part of my testimony.

(The following information was subsequently received for the record:)

CHAMBER OF COMMERCE OF THE UNITED STATES,
Washington, D.C., May 19, 1971.

Chairman, Subcommittee for the Consumer, Committee on Commerce, U. S. Senate, Washington, D.C.

DEAR SENATOR MOSS: Pursuant to your request at the time of our April 29, 1971 testimony on S. 984, S. 1222, and S. 1378, consumer class action bills, the National Chamber submits this letter and requests its inclusion immediately following our testimony in the record of hearings.

You referred to a National Chamber *Washington Dial* program supposedly made available on April 28, 1971. For the record, *Washington Dial* is a daily taped summary of Congressional action on legislative proposals of major interest to the business community. During Congressional recesses, *Washington Dial* sometimes carries editorials concerning issues of paramount importance to the business community. *Washington Dial* may be used by any individual in America who desires to dial (202) 223-0580.

The National Chamber's *Washington Dial* program available to those who called in on April 28, 1971, covered six items: public service employment, environmental class actions, welfare, consumer class actions, private pensions, and banking reform. The report on consumer class action was as follows:

"Consumer Class Action. Assistant Attorney General McLaren told the Senate Commerce Consumer Subcommittee Tuesday that class action is not the panacea for consumer problems as some consumer advocates claim. The Subcommittee will hold another day of hearings on class action Thursday.

"Meanwhile another Congressional Subcommittee is engaged in hearings on what many consider to be the most important consumer legislation ever. The House Subcommittee on Legislation and Military Operations is studying Rep. Benjamin Rosenthal's bill that would create an independent consumer protection agency. The agency would have the power to intervene, on behalf of consumers, in any investigation, hearing or other proceeding in or before any Federal agency. A National Chamber spokesman is testifying before the Subcommittee today."

The language in the April 28, 1971 *Washington Dial* program does not track the material you quoted following our testimony. Our *Washington Dial* staff researched the stated language in order to discover when and where it could have been aired and monitored. It was found that the material quoted was contained in a *Washington Dial* editorial on consumer class actions aired April 14, 1971—during the Senate's Easter recess. The full text of the April 14, 1971 editorial follows:

"This Is Washington Dial for Wednesday, April 14, a legislative information service of the Chamber of Commerce of the United States.

"The Ads Which Business People may have been billing class action legislation as the 'get your money back law' are only a sample of the kind of consumer agitation that will be engaged in not only by the leaders of special consumer interest groups, but possibly by the so-called public interest law firms in the event Congress does open the Federal courts to class action suits against business.

"The District of Columbia Bar Association recently set a precedent especially disconcerting to business when it lifted its sanctions against advertising by the allegedly non-profit law firms that would seek out disgruntled consumers to participate in class actions against business. The firms would now be able to advertise for class action clients through newspapers, radio and television. The possibility is strong that the precedent will spread to other states, but even if it doesn't, there's every indication the leaders of the consumer groups will themselves advertise for dissatisfied consumers to participate in a suit.

"A great danger is that the class action suits would be directed at legitimate businesses, based on their ability to pay large damages rather than on their guilt. In many cases the filing of a class suit could amount to legal blackmail against a legitimate firm. The cost of fighting an extended legal battle, and the damage a company could suffer in its public relations, even if innocent, might compel it to agree to some kind of monetary settlement with the leader of the special interest groups as the lesser of two evils. In many cases, whether the business loses its case or makes a settlement, it will be the lawyers who benefit the most, and not the consumers.

"The business community is joined in its opposition to class action legislation by prominent jurists who are alarmed that it would further burden the Federal court system with thousands of harassing suits against business, instigated in many cases by special interests in search of personal gain. Even Chief Justice Burger of the Supreme Court has warned of the dangers of nationwide class actions.

"At the request of President Nixon the National Institute for Consumer Justice is now making an intensive study of all the available methods of providing consumers with protection from fraud by unethical or fly-by-night business operators. Some of the methods under consideration include arbitration of consumer claims, strengthening of state small claims courts and even a plan whereby the government would recover damages for the consumer in clear-cut and proven cases of fraud.

"The National Chamber believes that these and other methods of consumer recourse deserve study before Congress enacts class action legislation that would clog the courts, harass legitimate business and reward a few special interests rather than the consumers who are subject to fraud.

"The Senate Commerce Committee and the House Interstate and Foreign Commerce Committee are both considering class action legislation in the 92nd Congress. Business people should call upon their Representative and both their Senators to work against passage of consumer class action legislation.

"*Washington Dial* will bring you another report on legislation of interest to business on Thursday, April 15."

I must convey our sincere disagreement regarding your characterization of the language contained in the April 14, 1971 editorial. Perhaps your strong reaction was generated by our vital concern about the unfair manner and degree in which consumer class action legislation would impact on legitimate members of the business community. We believe merely delegating the duty of filtering out strike and harassment suits to the bench and bar is not a reasonable nor sufficient answer to problems inherent in consumer class action legislation.

Regarding the text of the April 14 *Washington Dial* editorial, the following explanatory comments should be made. In paragraph one the reference to class actions as the "Get Your Money Back Law" came from a full page advertising flyer distributed by the Consumer Federation of America last year. The reference to public interest law firms, in paragraphs one and two, relates to a recent District of Columbia Bar Association interpretation of its code of ethics; and the activity alluded to is illustrated by a recent advertisement published in the February 27, 1971 edition of the *New Republic* magazine entitled "A Public Service Legal Opinion About Your Child's Hazardous Toys" by the Stern Community Law Firm which was circulated to roughly 125,000 persons.

Paragraph three gets to the real heart of the problem posed by the current consumer class action bills. As our statement to your subcommittee pointed out, technical violations, causing little or no consumer harm, have been the typical subject of class actions under current law and would undoubtedly comprise the greatest share of consumer class actions under the bills presently pending before the Congress. Moreover, the subcommittee has repeatedly heard testimony indicating that consumer class actions would *not* be brought against hard-core consumer fraud operators who cause substantial consumer harm, but rather against legitimate business because as a practical matter highly visible assets are necessary for the maintenance of a consumer class action. Finally, most businesses would be forced to accept out of court settlements on trivial claims rather than risk the damage to their reputations that would inevitably result from bad publicity since the publicity concerning a successful class action defense would surely never equal the publicity given the institution of the class action.

In these circumstances—which we believe would be typical under the language of current bills—is it extreme to say that the institution of the class action “could amount to legal blackmail against a legitimate firm”? We think not.

The last sentence in paragraph three states, “In many cases . . . it will be the lawyers who benefit the most and not the consumers.” The *Playboy* and *Yellow Cab Company* cases have been cited repeatedly as good authorities for this point.

Your criticism of paragraph four regarding the statements of Chief Justice Burger does not dispute our main point which is that the Chief Justice specifically surfaced consumer class actions as one of the types of proposals which would place undue strains on our judicial system. The exact language of the quotation regarding consumer class action follows:

“As to the future I can do no more than emphasize that the Federal court system is for a limited purpose and lawyers, the Congress and the public must examine carefully each demand they make on that system. People speak glibly of putting all the problems of pollution, of crowded cities, of consumer class actions and other in the Federal courts. We should look more to state courts familiar with local conditions and local problems.”

The next two paragraphs of the editorial relate to the mission of the National Institute for Consumer Justice and the general position of the National Chamber on consumer class action legislation. I assume these and the remaining paragraphs relating to the status of the legislation and suggesting that our members communicate with their Congressmen and Senators, are non-controversial.

If indeed there is an “emotional” flavor to the April 14 *Washington Dial* message, it reflects the very real fear felt by businessmen all across this country concerning the threat to their savings, livelihoods and reputations which they see inherent in your bill. We deeply share your concern that new consumer remedies must be found, but it is not possible to overstate the apprehension of *legitimate* businessmen toward the consumer class action approach.

Nevertheless, as was noted by our witness, we do indeed support a reasoned approach to legislative problems. Given the gravity of current consumer class action proposals and the apparent lack of Congressional concern over the unfair impact such legislation would have on the business community, we do not believe that the editorial recited on April 14 departs from this philosophy. Indeed, we hope that it has stimulated many of our members to contact their Senators and Representatives to indicate that a more reasoned approach to the consumer remedies legislation is necessary.

We stand ready to help the committee consider methods of consumer redress which will provide the consumer with the protection he needs so much without placing needlessly on a bullseye the reputations of thousands of reputable businesses across the nation.

Sincerely,

KENNETH F. STINGER,
Consumer Issues Attorney.

Senator Moss. We welcome that, and we certainly will consider your language very carefully and seriously, making changes of a sort that you think would improve the legislation, and, certainly, I do believe you gave a reasoned statement.

I am not trying to indicate that you were not, but I was a little upset over the broadcast on the telephone.

Senator Hart, do you have any questions to ask the witness?

Senator HART. No.

I would say the testimony was specific, reasonable, to the point, and unemotional, and the kind that would be helpful.

Senator Moss. Thank you very much, gentlemen. We appreciate your appearance.

(The statement follows:)

STATEMENT OF IRVING SCHER, FOR THE CHAMBER OF COMMERCE OF THE
UNITED STATES

Mr. Chairman and distinguished members of the subcommittee, my name is Irving Scher. I am a member of Weil, Gotshal and Manges, a New York City law firm. I am privileged to appear before you today on behalf of the National Chamber, as a member of its Consumer Issues Committee. Accompanying me is Kenneth F. Stinger, staff attorney for the Chamber's Consumer Issues Committee.

The Consumer Issues Committee was established four years ago to help develop the National Chamber Federation's posture on important issues affecting the interrelationship of business and the consumer, and also to increase the level of business attention to consumer needs and wants. A broad spectrum of business leaders including executives of manufacturing, retailing and service companies, both large and small, as well as trade associations and state and local chambers of commerce is represented on the Committee.

Last year a representative of the National Chamber testified before this subcommittee on the important issue before you—direct consumer remedies against unfair and deceptive trade practices. He stated that an essential consumer need was strengthened legislation designed to prevent consumer fraud and deceptions from occurring. To this end, we endorsed legislation to strengthen the powers of the Federal Trade Commission. And just a few weeks ago, we again urged such legislation in this subcommittee's hearings on S. 986 and S. 1219.

In its testimony last year, the National Chamber recognized also a need for more meaningful forms of consumer redress and in particular more efficient means to handle consumer complaints promptly and effectively. The Chamber stressed that it would support meaningful regulation designed to achieve these goals. But we, as well as the other representatives of the business community who testified in the 91st Congress, oppose consumer class actions as not being a viable solution.

A number of basic arguments were made repeatedly in testimony before both this subcommittee and the Senate Judiciary Committee. Specifically we and other business representatives contended that:

1. Class actions are either ineffective, or unusable, or will not be used to remedy complaints and abuses generally experienced by consumers;
2. Class actions will instead be employed against legitimate well-endowed companies in cases furthering little or no public interest, and which would be better handled through other enforcement mechanisms;
3. Class actions are complex, cumbersome, and protracted and by their nature discourage early or efficient resolution of consumer claims; and
4. Class actions place a heavy management burden on the courts, and the type which will be encouraged by the bills before this subcommittee will create an undue strain on the judiciary.

Considerable testimony has been presented in connection with these arguments. I will address most of my comments to specifics which may not as yet have been made clear, and which are based on my own observations and experience as a private practitioner dealing, for about ten years, almost exclusively with Federal Trade Commission and antitrust matters.

THE ROLE OF CONSUMER CLASS ACTIONS

Lost in the voluminous testimony on the subject is the fact that, for the most common types of consumer complaints, class actions offer absolutely no promise of relief. Most consumer complaints involve such problems as poor product performance, poor quality merchandise, service inadequacies, billing

errors, and late or lost deliveries. This was borne out in a very recent Federal Trade Commission survey of 8,800 complaints, a Council of Better Business Bureau's study of some 80,000 complaints, and a recent study of over 1,700 of the complaints received by the President's Special Assistant for Consumer Affairs.

These typical consumer complaints totally lack the "commonality" required for class actions. Under Rule 23 of the Federal Rules of Procedure, they typically involve one consumer and one supplier. Those who countend that class actions will actually provide relief for these everyday problems, or that a class action statute would be a "Get Your Money Back" law for consumers bothered by such problems, are themselves engaging in the cruelest kind of fraud.

Possible solutions to these problems will be studied by the National Institute for Consumer Justice. These include more effective small claims courts, neighborhood courts, more efficient individual and industrywide voluntary settlement mechanism, binding consumer arbitration, and improved state and local enforcement agencies. In most instances, all that may be required is direction of a complainant to the proper person in the supplier's organization. Yet these types of problems appear in the lists of statutory violations subject to class actions in each of the bills now before the subcommittee.

Hard-core frauds such as bait and switch devices, fraudulent referral schemes, or unconscionable markups will also rarely be challenged in class actions brought by the private bar. Most private practitioners would not consider it worth their while to undertake such a suit, for these practices generally occur in low-income areas and are typically perpetrated by here-today, gone-tomorrow fringe operators, who hit an area quickly and then disappear. This would certainly be confirmed by local consumer protection agencies such as the New York City Department of Consumer Affairs.

What is needed to combat hard-core fraud is strengthened governmental enforcement, including preliminary injunction powers, stronger civil penalties, and perhaps stronger criminal penalties. Where real consumer abuses cause serious monetary loss, provision should be made for restitution, rescission of contracts and negation of unexecuted consumer obligations.

Proponents of consumer class action legislation fail to recognize the wide variety of instruments seeking to control undesirable behavior. The approach suitable for one problem may be totally inappropriate for another. There is no panacea. *The question to be asked in each instance is "Which method promises the swiftest, most efficient remedy for the harm being claimed?" Consumer class actions will rarely be the answer.*

Where, then, will consumer class actions be generally used? The experience is already at hand in connection with the Federal Truth-in-Lending Act, which provides for both governmental and private class action enforcement against those who fail to comply with consumer credit disclosure requirements. Those knowledgeable in the field recognize that there is minimal compliance in low-income areas. Acting in the public interest, the Federal Trade Commission has successfully brought actions against companies operating in low-income areas. On the other hand, with no public interest to protect virtually all of the private cases filed have been class actions against major national corporations, and have involved subtechnical matters as failing to use the precise words required by the statute although all essential information has been disclosed. Five of these actions have been instituted by the same law firm with its attorneys or office staff as named parties, and three actions have been instituted by another firm.

Congress should not repeat this mistake. It should not enact further legislation which will set up legitimate business enterprises as high visibility targets for bounty hunters. But if the Truth-in-Lending experience serves as a guide, this is just what will result from such broadly defined consumer class action bills as are now under consideration. The lists of infractions subject to class actions under these bills encompass virtually the myriad of practices prohibited by Section 5 of the Federal Trade Commission Act. S. 984 goes even one step further and actually includes *all* such practices.

Most Section 5 violations do no substantial harm to individual consumers. Harm is not required. The statute is not a fraud law but instead, prohibits practices which may tend to deceive. Thus, typical violations involve such practices as: the misuse of "Regular Price" when "Former Price" should

be advertised; claims that a sewing machine is an "automatic zig-zag" when it should be designated just "Zig-Zag"; failing to disclose the use of plexiglass in a commercial allegedly demonstrating that sandpaper could be shaved with a shaving cream—even though the claim was true; labeling a "split leather" belt as "leather"; or failing to note in an advertisement that costume jewelry is made in Japan, even though the package and product make such a disclosure.

Thousands upon thousands of such advertising and labeling practices have been challenged by the Federal Trade Commission and prohibited under Section 5. I refer the subcommittee to Volume 2 of the Commerce Clearing House Trade Regulation Reporter where the cases have been collected. While there might be a legitimate role for government in controlling such practices Congress should not establish private causes of action in this area with mass recoveries authorized where, at best, the financial harm to the consumer is speculative.

The subcommittee should not labor under the delusion that class actions will not be instituted in cases involving technicalities or trivia. *Hall v. Coburn* 26 N.Y. 2d 396 (N.Y. 1970), was a class action involving the legality of the type size used in installment contracts. The case was litigated for years before it was finally dismissed by the highest court of the state of New York as unwarranted and not in furtherance of any public need.

The Federal Trade Commission itself has been seeking to establish new principles of law in a number of cases involving television advertisements. These cases deal with problems such as "overglamorized" commercials, demonstrations exaggerating or not actually proving a valid claim, advertising unique claims for products but failing to disclose non-unique factors as well, and substantiating a claim in a manner which the Commission contends to be insufficient. In these cases the Commission is seeking to deal with developing marketing concepts and to fashion new remedies. But it has been proceeding very carefully even though the cease-and-desist orders it issues have prospective applications only.

Indeed, there is pending right now in the District Court for the District of Columbia a consumer class action against an analgesic manufacturer, *Holloway v. Bristol Myers Corp.*, in which damages are being sought in connection with an allegedly false claim as to the speed with which the defendant's product acts. The plaintiffs contend that they already have a private right of action under the Federal Trade Commission Act. The potential class of plaintiffs has been estimated at 117 million persons, with individual damages estimated to average less than a dollar each. Before statutory authority is granted to allow such class action, Congress should carefully determine whether any real consumer need would be furthered. Without even taking into account the overburdening effect these cases would have upon the courts, it must be concluded that such practices are best dealt with by governmental agencies. Civil penalties could be authorized when appropriate to deal with practices causing widespread, but individually trivial consumer harm.

The Federal Trade Commission has carefully selected its respondents and is determining the form and extent of relief to seek on the basis of a number of factors such as dominance of the company involved, nature of the wrong, and the extent and type of consumer injury or competitive harm.

These are public interest determinations, in contrast to those which motivate an attorney's decision to institute a private class action. Such suits are motivated by totally different, non-public interest factors. However, the bills before this subcommittee would place a destructive weapon in the hands of private parties for use in cases involving over 100 million television viewers in each instance.

It would be both unwise and unfair to expose businessmen to long and expensive litigation involving massive classes of plaintiffs in connection with unarticulated principles of law. Indeed, such suits could cause the courts to react with overly restrictive interpretations of statutory terms intended by Congress to allow for expansive treatment by a Federal agency.

PROTRACTED LITIGATION AND JUDICIAL MANAGEMENT

Much has been said as to the intolerable burden that consumer class actions would place upon the courts due to the complex and protracted nature of such cases. Recent decisions demonstrate vividly the truth of these contentions.

Quite simply, it cannot be said that the Federal Rules of Civil Procedure, or Rule 23 in particular, provide sufficient built-in protections against unwarranted or unmanageable class actions, or that such class actions can be dismissed early in the proceeding. In *Dolgow v. Anderson* (2d Cir. Sept. 2, 1970), an attempt by a federal judge to grant summary judgment, dismissing, under Rule 23, what he believed to be a frivolous class action was reversed as being too hasty, despite the fact that the court did not even attempt to dismiss the action until the conclusion of discovery proceedings involving more than 7,600 pages of documents, 12 sets of interrogatories covering 357 categories of information, 14 sessions of depositions, encompassing 1,500 pages of transcript and 12 hearings!

As to the protracted nature of class actions, the first real consumer class action *Eisen v. Carlisle & Jacquelin* instituted under the antitrust laws in 1966 under amended Rule 23 is still before the trial judge. Indeed, earlier this month, the court finally ruled a class action was appropriate. But it also ruled that it could not yet determine who should pay for the required notice to the 3,750,000 claimed members of the consumer class involved in the action, which was started by one consumer with a \$70 claim. Indeed, it took five years for the court even to begin to work out the mechanics of notice to the prospective class which will be accomplished at an estimated cost of \$500,000. It will involve personal notice to but 2,000 members of the class, despite the fact that two million members of the class were identified by the defendants a few years ago.

Eisen is one of the few cases as to which judicial experience can be considered, for not one class action has been fully litigated since the amendment of Rule 23 in 1966.

If a case involving a class composed largely of identifiable consumers has created such difficulty, imagine the problems which will be involved in determining the makeup of a class and the manner of providing even initial notice in a case involving television commercials viewed by more than 100,000,000 persons. Yet, it is just this type of class action which the bills before this subcommittee will promote.

ESSENTIAL CONSIDERATIONS IN CLASS ACTION LEGISLATION

This subcommittee is considering three bills which, purportedly, attempt to come to grips with the problems inherent in class action litigation. But, the treatment is unsatisfactory, and the bills simply do not accomplish the objectives being sought. Each contains specific defects that demonstrate the basic difficulty in trying to apply one form of remedy to all consumer ills—and class actions in particular.

It is essential for any class action bill to deal meaningfully with the perplexing problem inherent in such protracted and cumbersome litigation. Specifically, any bill must provide an adequate measure of predictability for businessmen as to the types of practices which can be the subject of such suits. Additionally, any bill must forcefully encourage the resolution of valid consumer complaints without resort to the courts, or at an early stage of litigation. Of greatest importance, strike suits and other unsuitable claims must be deterred. Finally, a method must be found in Federal class action legislation to preserve to the state courts a jurisdiction which is appropriate to such courts.

The present bills do not satisfactorily deal with each of these points.

1. *Defining class action subject matter.* S. 984 would permit class actions for each and every act or practice prohibited by Section 5 of the Federal Trade Commission Act (Sec. 101 (1) (p)). S. 1378 would include any practice which gives rise to civil liability under state law for the benefit of consumers (Sec. 3(a)(4)). Such provision eliminate any measure of predictability for businessmen as to the practice which may create class action liability. Nor can these provisions be linked to any demonstrated consumer need.

The areas of coverage have not been carefully thought out and are not succinctly defined. Even the "Laundry lists" contained in all three bills are much too broad and vague. For example, one of the items in each list would allow class actions against all misleading statements concerning a product's performance, uses, or benefits. This could cover virtually all possible product claims. Thus, a businessman is advised only that any claim he makes may generate a class action.

A greater measure of predictability might possibly be achieved by assigning a role to the Federal Trade Commission as the vehicle for providing a more precise delineation of covered practices. The Commission might be able, if so authorized, to conduct hearings with adequate participation by all concerned and appropriate judicial review, designed to establish whether a particular practice is subject to misuse in a manner substantially injurious to many consumers. If this is determined to be the fact, a detailed and specific rule dealing with the problem might be issued to become subject for class action relief against those involved in the prohibited practice after the effective date of the rule.

This type of procedure is dealt with in Sec. 3(a)(5) of S. 1378, but unfortunately, in addition to, rather than in lieu of, other provisions establishing overly broad categories of practices subject to class actions. Lessening predictability even further, S. 1378 totally eliminates the minimally essential standard permitting class actions only if the unfair consumer practice was committed with knowledge.

2. *Consumer relief other than through extended litigation.* All three bills recognize the need to administer class actions in a manner facilitating voluntary settlement. But none really accommodates settlement procedures. Only S. 1378 seeks to avoid litigation entirely through pre-litigation settlement techniques. But even this provision—Sec. 11—requires substantial revision for it would require the supplier to identify each member of the class rather than to exert a good faith effort to identify all such members. And, it would allow too short a period for settlement. Further it fails to account for the depreciated value of merchandise which must be returned as a condition for refund.

All three bills purport to encourage settlement during the pendency of a class action, but none allows the court to adopt a defendant's reasonable settlement offer as judgment in the case, while permitting non-settling consumers the ability to continue independent actions. Such a modification is essential for the case law demonstrates that Rule 23 does not provide judges with sufficient control over the litigation.

3. *Weeding out improper suits and avoiding lengthy litigation.* There are a number of ways to protect businessmen and the courts against frivolous and unwarranted class actions. S. 1222 provides that class actions can only be brought after successful government action. But S. 984 and S. 1378 contain virtually no screening device. Such mechanisms are necessary to inject an essential public interest element into private class action litigation.

Should this subcommittee determine that the institution of class actions need not await some form of governmental approval, every effort should be made to provide the court with as much authority as possible to deter and dismiss unwarranted suits as well as to facilitate the termination of a class action when appropriate relief is available to the class and the public interest is otherwise satisfied.

A number of devices could be considered in order to assist the court in performing this essential role as protector of the public interest.

For example, although Sec. 12 of S. 1378 provides the court with discretion as to the party required to pay the costs of notice to the class, it does not require an early hearing in order to resolve this question. Nor does it require such an early hearing to determine whether the claims are of such a nature that a bond should be required of the plaintiffs—as is already provided for in derivative class actions. The court could also be permitted where appropriate to serve notice after such a hearing that the plaintiffs may be assessed costs or attorney's fees if unsuccessful.

These are but examples of the kind of protective mechanisms which should be considered in order to give the court more control over the course of class actions. There are others, such as the provision discussed earlier which would require pre-litigation settlement efforts and which would allow the judge to adopt a defendant's reasonable settlement as judgment in the case.

FEDERAL-STATE RELATIONSHIPS

Congress must also be careful not to construct Federal causes of action which will swallow up typical state court matters of a local nature. Congress must also avoid any substantial overlap and confusion when relief is sought in both Federal and state courts for the same consumers in the same trans-

actions. A statutory formula should be devised for a sensible allocation of matters between Federal and state courts. Perhaps local matters involving local citizens and others injured within but one state should be handled only by the state courts, and claims involving multistate classes of plaintiffs should be exclusively handled by the Federal courts—as under the Federal antitrust laws. There is an attempt in this direction in Sec. 5 and 6 of S. 1378. However, these provisions do not provide for exclusive jurisdiction of local matters in the state courts and exclusive jurisdiction of national matters in the Federal courts.

CONCLUSION

We said last year that consumer class actions will not provide an expeditious or meaningful remedy for consumers against unfair and deceptive trade practices, but will pose an excessive economic threat to legitimate business and to the courts. Events of the past year bear out, we believe, the essential validity of our position.

Nevertheless, should Congress determine that some form of consumer class action legislation must be enacted, it is essential that the law deal meaningfully with the important issues and safeguards we have mentioned today.

On behalf of the National Chamber, I am grateful for the subcommittee's attention and consideration of these views.

Senator Moss. Our next witness is Mr. Eugene Keeney who is president of the American Retail Federation.

Mr. Keeney, we are glad to have you before us again.

STATEMENT OF EUGENE ADAMS KEENEY, PRESIDENT, THE AMERICAN RETAIL FEDERATION; ACCOMPANIED BY JAMES M. GOLDBERG, VICE PRESIDENT

Mr. KEENEY. Happy to be with you again, Senator.

I have with me the vice president of the federation, James M. Goldberg, and at your suggestion, we have taken our testimony which we understand will be reproduced in full in the record and an attempt will be made to summarize it for you.

Senator Moss. Thank you for that. It will appear in full in the record.

Mr. KEENEY. The American Retail Federation is a national organization which, through its 50 State and 28 national retail association affiliates, represents more than 1 million retail establishments across the country.

We appear here today to restate the retail industry's strong conviction that consumers who have been victimized by fraud are entitled to a remedy that is, in the words of Mrs. Virginia Knauer, the President's Special Assistant for Consumer Affairs, "fast, efficient, and effective."

We restate, with equal conviction, our belief that class actions do not provide such a remedy. We believe this especially since retailers are at the first line. They are the people, they are the men and women who meet the consumers every day of their working lives.

We are interested in a remedy or any amount of remedies that would be fast, efficient, and effective. In our judgment, of course, class action is not the answer to a fast, effective, and efficient remedy. We do, however, have constructive alternatives to propose.

The kind of relief preferable to class actions was summarized best perhaps by New York attorney Milton Handler who told the Senate Committee on the Judiciary last year that "preventive justice is

much more effective than compensatory justice when compensatory justice may be a snare and a delusion."

The FTC has now proposed legislation before this committee regarding an expansion of its authority to matters affecting commerce and which would grant the Commission the authority to seek preliminary injunctions to stop fraud before it preys on consumers. We support this legislation. This is a constructive alternative.

Another constructive alternative is being presented by one of our State retail associations. The Pennsylvania Retailers Association will soon begin a pilot arbitration program with the cooperation of the National Center for Dispute Settlement. We believe that this program is a experiment that could produce worthwhile results.

The use of such informal disputes settlement mechanisms, without primary reliance on costly and time-consuming court proceedings, has also been recognized by this committee. In S. 986, the pending warranty bill, section 110 notes:

Congress hereby declare it to be its policy to encourage warrantors to establish procedures whereby consumer disputes are fairly and expeditiously settled through informal dispute settlement mechanisms.

Another alternative that is now in the works in order to help provide a fast, effective, and efficient remedy for the consumer is the National Institute for Consumer Justice. The creation of this Institute to study means and mechanisms of consumer remedies should go a long way toward providing solutions which meet these criteria. Further, the FTC has announced its intention to organize consumer advisory boards in each of the cities where the Commission maintains field offices. We hope that retailers in the cities where the boards are located will be given an opportunity to work closely with them in providing still another avenue of consumer help.

Another alternative which may not yet have been brought to the attention of the committee which should be considered, and which we are studying ourselves and have no judgment yet, but it is another constructive alternative which may be fast, effective, and efficient, is S. 1602, introduced by Senator Pearson.

S. 1602 is a bill to provide assistance to encourage States to establish consumer claims courts. It certainly is worthy of consideration, not only by the Judiciary Committee to which it has been referred, but by this committee, because it does appear to be a bona fide effort by way of constructive alternative to the class action proposal.

Now, with respect to the problems of class action, there have been a number of developments that have occurred since last we testified.

Congressman Scheuer, a cosponsor of a consumer class action bill, noted recently in a press conference that congressional enactment of this legislation would cause the formation of "a whole new bar"—and those were his exact words—of consumer-activist attorneys.

This subcommittee just recently discussed, about an hour ago when Senator Cook was here, the now famous Playboy Club class action, a suit which, incidentally, was never fully litigated, but which was settled under court approval. The consumers involved received chits good for \$8 in food and refreshments at Playboy Clubs; the attorneys involved, one of whom was the plaintiff, received \$275,000.

Last year, a California Superior Court judge brought to a close a long-standing class action against Yellow Cab Company of California. The return to the attorneys involved, one of whom was the plaintiff, was \$200,000. The other members of the class received no cash settlement.

Future taxi fares will theoretically be reduced over a seven and a half year period, but the reduction is from an approved regulated rate structure which will clearly fluctuate in the public interest.

This was not fast, effective and efficient remedy for consumers.

The *Yellow Cab* case points out another fault in class actions, their length. The original claim in the case was filed in 1964, and going over charges as far back as 1960. Thus, between the initial fare overcharge and the court settlement of the case, more than 10 years elapsed. It may be another 7 years before the ultimate return is made to the consumer, bringing to 17 years the total amount involved.

At this point it is interesting to note the history of one of the first massive consumer-oriented class actions brought under amended rule 23. Mr. Scher referred to it. It is the *Eisen* case involving alleged overcharges and commissions for odd-lot stock purchases. It has resulted in five written court opinions at various judicial levels in its 5-year history.

The latest opinion was handed down April 7 of this year by District Judge Tyler of the United States District Court for the 7th district of New York. It has taken more than 5 years to reach the point where a Federal district judge believes that a preliminary hearing should be convened to consider the merit of the plaintiffs' case in order to determine who shall bear the burden for paying of the notice of the class action which must be communicated to more than one million members of the class.

More than anything else, retailers value and cherish good will. And the loss of good will by publicity is of utmost concern to us when we consider this legislation.

In the interim between the commencement of a class action and the measuring of its validity against a yardstick of Federal rule 23, the defendant has been subjected to considerable adverse publicity. Sadly, it has been the experience of many class action defendants that their first knowledge of the lawsuit has come from a reporter who is calling to inquire how it feels to be sued for many millions of dollars. The reporter, of course, got his knowledge from a telephone call from the plaintiff or his attorney who seem as interested in trial by publicity as in trial by the judiciary.

The bringing of a five, six, or seven figure class action suit makes news, usually on page one. The dismissal of such a suit does not rate the same kind of newspaper space. The defendant, the retailer, often the case, is irreparably harmed.

In conclusion, Mr. Chairman, we reiterate our opposition to class actions as an effective means of consumer redress. They promise much, but deliver little. There are a number of constructive alternatives which should be explored before Congress offers the consumers of this country a promise of relief which is not fast, efficient, and effective.

Senator Moss. Thank you, Mr. Keeney, for that statement. The full text will be in the record, and I appreciate your pointing out what alternatives you think there are to obtain quick and effective

relief for consumers who are by some reason victimized, damaged, or misled in their purchases of production, and I appreciate your concern.

We find the same two or three cases that are cited again and again on class action such as the *Yellow Cab* case.

I do not defend that case. In fact, I could hardly see how we could expect to recover for overcharging fares over a long period of time for anything as undefined a class as those who rode in a Yellow Cab, so I am surprised that there is any kind of judgment at all rendered in the case. But, nevertheless, that is one that concerns you and concerns a lot of others thinking that class actions might all devolve into that category.

I might point out that, perhaps, the experience with class actions, there might be a guidance as to controlling class actions if they are extended to consumers generally rather than this derivative type that is brought in the *Yellow Cab* case.

So, I don't think that that should stand as a bar to our consideration of the legislation before us, but they certainly ought to be aware of the pitfalls that exist, and certainly we appreciate having your comment about it.

Senator Hart, do you have any comments or questions?

Senator HART. I appreciate your comments. One thing; there is nothing new about this comment. One thing that we have to attempt to feed into the operation in the Committee and its reactions to these bills here about class actions is a basis reasonably to hope that it will prevent the kind of customer disappointments which, if they occur, give rise to class actions or give rise to the frustration, "It doesn't work and I can't get my money back."

Mr. KEENEY. I wish I could say affirmatively that class action did offer some offer of hope as far as the consumer was concerned. We retailers throughout the country desperately have to satisfy the consumer because if he or she doesn't come back to the store, that means that he or she is not satisfied.

We have offered a number of constructive alternatives and we certainly are open minded for any others that would provide a fast, effective remedy for the customer. But, in our judgment, this doesn't really help the consumer right now at the point of time when he needs this relief.

Senator HART. Our question is whether it provides a fast, effective remedy for the customer who is disappointed and let us assume reasonably disappointed or disappointed with reason. The second question that I was suggesting is, maybe, there would be fewer customers disappointed if producers realized that there is the potential of a million dollar judgment for failure to provide an acceptable consumer product. This is another fact that the Committee will give thought to as it evaluates the consumer class action.

Senator Moss. Thank you, Mr. Keeney and Mr. Goldberg.
(The statement and attachments follow:)

STATEMENT OF EUGENE ADAMS KEENEY, ON BEHALF OF THE AMERICAN
RETAIL FEDERATION

Mr. Chairman, Members of the Subcommittee, my name is Eugene Adams Keeney. I am President of the American Retail Federation, a national organization which, through its 50 state and 28 national retail association af-

franchises, represents more than one million retail establishments across the country.

We appear here today to restate the retail industry's strong conviction that consumers who have been victimized by fraud are entitled to a remedy that is, in the words of Mrs. Virginia Knauer, the President's Special Assistant for Consumer Affairs, "fast, efficient, and effective."

We restate, with equal conviction, our belief that class actions do *not* provide such a remedy.

BILLS UNDER CONSIDERATION

Three major bills are under consideration by this Subcommittee. S. 984, the Consumer Class Action Act of 1971, is sponsored by the distinguished Chairman of this Committee and 19 other Senators. It would permit one disgruntled consumer to bring a class action in federal district court on behalf of many other consumers if he only notifies the Federal Trade Commission 90 days in advance of the suit.

Class actions would lie for 15 enumerated types of fraud, plus "*any other act or practice which is unfair or deceptive to the consumer and which is prohibited by Section 5(a)(1) of the Federal Trade Commission Act*" (emphasis added). This so-called "catch-all clause is so broad that the listing of specific frauds is made unnecessary.

S. 1222 is the Administration's Consumer Fraud Prevention Act of 1971. It, too, has a "laundry list" of specific violations, but it permits consumer class actions only after the termination of a successful prosecution by either the Department of Justice or the FTC.

S. 1378, sponsored by Sen. Bayh and others, also encourages consumer class actions, based not only on violations of federal law, but also in violations of any "state statutory or decisional law for the benefit of consumers."

None of these bills would, in our opinion, provide the kind of relief which would benefit consumers.

CONSTRUCTIVE ALTERNATIVES

The kind of relief preferable to class actions was summarized best, perhaps by New York Attorney Milton Handler, who told the Senate Committee on the Judiciary last year that "preventive justice is much more effective than compensatory justice when compensatory justice may be a snare and a delusion."

Consequently, we have testified recently before this Subcommittee in support of legislation which would expand the authority of the Federal Trade Commission to those matters "affecting" commerce, and which would grant the Commission the authority to seek preliminary injunctions to stop fraud before it preys on consumers.

One state retail association, Pennsylvania Retailers Association Inc., will soon begin a pilot arbitration program with the cooperation of the National Center for Dispute Settlement. (A summary of how this program will work appears as Appendix A.) We believe that this program is an experiment that could produce worthwhile results.

The use of such informal disputes settlement mechanisms, without primary reliance on costly and time-consuming court proceedings, has also been recognized by this Committee. In S. 986, the pending warranty bill, Section 110 notes:

"Congress hereby declares it to be its policy to encourage warrantors to establish procedures whereby consumer disputes are fairly and expeditiously settled through informal dispute settlement mechanisms."

The President of the United States has also recognized the need for fast, effective consumer remedies. The creation of the National Institute for Consumer Justice to study means and mechanisms of consumer remedies should go a long way toward providing solutions which meet these criteria. We state publicly today that the retail industry stands ready to cooperate in any manner possible to make the work of the Institute a success.

In addition, the Council of Better Business Bureaus has recently reorganized and revitalized its activities. We believe that the "new" Better Business Bureaus will provide many voluntary solutions to consumer problems.

Further, the Federal Trade Commission has announced its intention to organize Consumer Advisory Boards in each of the cities where the Commis-

sion maintains field offices. We hope that retailers in the cities where the boards are located will be given the opportunity to work closely with them in providing still another avenue of consumer help.

PROBLEMS WITH CLASS ACTIONS

The problems which the retail industry has observed with class actions are well known to this Subcommittee. They were stated by us, and many other witnesses during 1970 when this panel held hearings on S. 3201.

However, there have been some developments since then which underscore our concern.

For Example, Congressman James Scheuer, a co-sponsor of a consumer class action bill in the House of Representatives, noted recently at a press conference that Congressional enactment of this legislation would cause the formation of "a whole new bar"—and those were his exact words—of consumer-activist attorneys.

This is precisely why we believe that class action legislation will never deliver to the consumer what it promises.

References in legislation to court supervision of attorney's fees will not hide the fact that all it takes is one consumer—and one attorney—to bring a class action. And the interests of the class are quickly subordinated to the interests of the attorney, who, even under a "reasonable fee" provision stands to reap a great financial reward.

This subcommittee is well aware of the now-famous Playboy Club class action, a suit which, incidentally, was never fully litigated, but was settled under court approval. (A summary of the issues involved in that case appear in Appendix B.) The consumers involved received chits good for \$8 in food and refreshment at a Playboy Club; the attorneys involved, one of whom was the plaintiff, received \$275,000.

On November 23, 1970, a California Superior Court judge brought to a close the long-standing action against the Yellow Cab Company of California. (A summary of the facts and issues appears as Appendix C.) The return to the attorneys involved, one of whom was the plaintiff: \$200,000.

The other members of the class received no cash settlement. Future taxi fares will theoretically be reduced, over a 7½ year period, but the reduction is from an approved regulated rate structure which will clearly fluctuate in the *public* interest.

LENGTH OF SUIT

The Yellow Cab case points out another fault in class actions—their length. The original claim in the case was filed in 1964, alleging overcharges as far back as 1960. Thus, between the initial fare overcharge and the court settlement of the case, more than 10 years elapsed. It may be another seven years before the ultimate return is made to the consumer, bringing to 17 years the amount of time involved.

A former practicing attorney now in government service told us recently that "any reasonable competent defense counsel should be able to prolong a class action for at least five years."

The converse of that proposition is that any competent plaintiff's counsel can run a case equally as long. Imagine if you will the "blackmail" potential on the small defendant who cannot afford the expense of defending a class action suit. And the large defendant who makes a judgment that it is far cheaper to settle than to stand the costs of extended litigation. No remedy is a good one where the procedure is so costly that it provides a substantially inducement for "buying off" claims rather than having them decided on the merits.

Rule 23, the federal rule governing the bringing of class actions, was amended in 1966. To our knowledge, no class action brought under the amended rule, has been fully litigated—both as to the makeup of the class and the merits of the suit—in those five years.

Many class actions have of course been brought under Rule 23, but those which have been settled in the plaintiffs favor—like the Playboy Club and Yellow Cab cases—have actually been settled without trial.

At this point, it is interesting to note the history of one of the first mas-

sive consumer-oriented class actions brought under the amended Rule 23. The case of *Eisen v. Carlisle & Jacquelin*, involving alleged overcharges on commissions for odd-lot stock purchases, has results in five written court opinions, at various judicial levels, in its five-year history.

The latest opinion, (Opinion #37524, 66 Civ. 1265) was handed down April 7 by District Judge Tyler of the U.S. District Court for the Southern District of New York.

It has taken more than *five years* to reach the point where a federal district judge believes that a preliminary hearing should be convened to consider the merits of the plaintiffs' case in order who shall bear the burden of paying for the notice of the class action which must be communicated to the more than one million members of the class.

This opinion indicates that it will be many more years before the plaintiffs receive any relief.

FEDERAL RULE 23

Those who support class action legislation contend that Rule 23 of the Federal Rule of Civil Procedure would act as an effective screening device to assure that courts are not overburdened by class action suits, by serving as a judicial "trigger" to the bringing of these suits.

Senators Bayh, Hart, Kennedy and Tydings made that point in an October 6, 1970 memorandum in which they pointed to the "stringent set of conditions" imposed on the filing of a class action suit in federal court by Rule 23(a) and (b).

This memo states that "in every case the plaintiff must satisfy the court that a true class action does exist and that it is the most efficient manner of proceeding."

However, it should be noted that these criteria must be satisfied only after the litigation has commenced, and after the initial pleadings have been filed. There is no pre-litigation screening to see whether the criteria of Rule 23 are met before the consumer, ad his attorney, go to the federal courthouse to file their papers commencing a class action. And it may take several months of motions and cross motions—at considerable legal expense—before the criteria are matched against the particular case.

LOSS OF GOOD WILL BY PUBLICITY

In the interim between the commencement of a class action and the measuring of its validity against the yardstick of Federal Rule 23, the defendant has been subjected to considerable adverse publicity.

Sadly, it has been the experience of many class action defendants that their first knowledge of the law suit has come from a reporter who is calling to inquire how it feels to be sued for many millions of dollars. The reporter, of course, got his knowledge from a telephone call from the plaintiff or his attorney, who seem as interested in "trial by publicity" as they are in "trial by judiciary".

The bringing of a five, six, or seven-figure class action suit makes news, usually on page one. The dismissal of such a suit does not rate the same kind of newspaper space. The defendant is irreparably harmed.

CONCLUSION

In conclusion, Mr. Chairman, we reiterate our opposition to class actions as an effective means of consumer redress. They promise much, but deliver little. There are a number of constructive alternatives which should be explored before Congress offers the consumers of this country a promise of relief which is not fast, efficient and effective.

APPENDIX A

PROPOSAL FOR A PENNSYLVANIA CONSUMER ARBITRATION SERVICE PILOT PROJECT, DEVELOPED BY REPRESENTATIVES OF THE PENNSYLVANIA RETAILERS' ASSOCIATION, THE PENNSYLVANIA LEAGUE FOR CONSUMER PROTECTION AND THE NATIONAL CENTER FOR DISPUTE SETTLEMENT OF THE AMERICAN ARBITRATION ASSOCIATION

I. PURPOSE

The operation on a pilot project basis of a comprehensive public service program for the private arbitration of disputes between consumers and business organizations to be known as the Pennsylvania Consumer Arbitration Service.

II. DEVELOPMENT OF PROGRAM DESIGN—ROLE OF PARTICIPANTS

A. This program design was developed by a joint committee composed of representatives of the Pennsylvania Retailers' Association (PRA), the Pennsylvania League for Consumer Protection (PLCP) and the National Center for Dispute Settlement of the American Arbitration Association (NCDS-AAA), through joint and separate discussions.

B. The three aforementioned organizations must agree on this design before the Consumer Arbitration Service becomes operative.

C. The NCDS-AAA has provided technical advice in the development of the arbitration design and performed a mediation role in helping to resolve differences over the development of the program design. It will continue to perform these functions.

III. JOINT POLICY COMMITTEE—PROGRAM REVIEW, EXPANSION, DESIGN CHANGES, ETC.

A. The Consumer Arbitration Service shall be governed by a Joint Policy Committee (JPC). The JPC will be composed of an equal number of representatives from the PLCP, the PRA and the NCDS-AAA but no more than three from each group.

B. The major functions of the JPC shall be:

1. To meet periodically to review and evaluate the CAS including its continuation.

2. To approve changes in the basic design.

3. To expand the CAS to new areas in the State.

4. To undertake efforts to provide necessary funding of the program.

5. To acquaint and inform potential users of the existence of the CAS.

6. To establish the ground rules for vendors participating in the program and the form of recognition, if any, to be accorded those vendors who participate.

7. To adopt specific arbitration rules which shall be applied to all cases arbitrated under the program (a copy of NCDS recommended rules is attached hereto).

8. To determine the subject matter jurisdiction and the dollar value jurisdiction of the program.

9. To establish the case administration fee structure and the arbitrator's fees.

C. Decisions of the JPC shall be arrived at by a consensus of its members.

IV. CONSUMER ARBITRATION SERVICE—SCOPE, PUBLICITY, EXPANSION, ETC.

The CAS will begin as a pilot project. The pilot project shall be confined initially to the Harrisburg and Philadelphia areas.

Once the pilot project has proven out, the CAS would be extended to other areas in the State. It is recognized that the pilot project must have sufficient opportunities to prove itself. This will depend, at least in part, upon the nature and degree of commitment to the use of arbitration by individual vendors as well as by individual consumers.

The extent to which potential users are made aware of the CAS is another factor which will affect the experience level. While a big publicity play in the media may not be necessary, effective communication to vendors and consumers is necessary. To some degree, such communications can be effectuated through participating organizations' communications with their respective membership. In addition, other organizations and agencies, private and public, which receive consumer complaints would be advised of the service. Initially publicity will relate to the fact of the service, its newness and experimental nature while avoiding extravagant claims and identification of specific cases, awards, etc.

Individual participating agencies would extend invitations to potential participants to join the program. The Joint Policy Committee shall determine which business groups or organizations may join as full participants.

The JSC shall determine the basis on which other than full participants may utilize the CAS. Other trade associations would be encouraged to endorse the program and share in its operating costs.

V. NATURE OF VENDORS' ARBITRATION COMMITMENT

It is understood that the Pennsylvania Retailers' Association cannot commit any individual retailer to arbitration in advance, anymore than the League can commit any individual consumer; the retailers nevertheless agree that it is desirable for a significant number of their members to commit themselves to the program so that the consumer arbitration unit may be assured of a base on which to work and so that retailers and service industries which have not agreed in advance to submit all disputes will nevertheless be encouraged to submit individual disputes. The Pennsylvania Retailers' Association agrees to work toward the objective of getting a substantial number of its members to commit themselves to submit all disputes. The Pennsylvania League for Consumer Protection agrees to encourage individual consumers to submit disputes to arbitration before resorting to litigation.

It is further understood that a full participating business is one committed to the use of arbitration in those instances where it is unable to resolve a consumer dispute directly with the customer.

VI. ESTABLISHMENT OF GRIEVANCE OR COMPLAINT PROCEDURES PRIOR TO ARBITRATION

Each participating business would be required to establish in clear and simple language its own step-by-step internal customer complaint or grievance procedure and undertake to make known such procedures to its customers.

Such procedures should clearly indicate the final internal step after which the customer or the vendor may request or trigger, as the case may be, the Consumer Arbitration Service.

Such internal procedure should be exhausted before the dispute is submitted to arbitration.

Each participating business would file with the CAS a copy of its internal complaint or grievance procedure.

While each business would establish its own internal complaint or grievance procedure, the Joint Policy Committee retains the right to disapprove any such procedure which tends to defeat the purposes of the program. The Joint Policy Committee may issue guidelines for an appropriate internal grievance or complaint procedure.

Any business not a full participant in the program but desirous of using the CAS on an ad hoc basis must be willing to discuss the appropriateness of arbitration in specific cases with a representative of the CAS, particularly when arbitration had been requested by a customer-complainant.

VII. THE CONSUMER ARBITRATION PANEL

The NCDS-AAA shall be responsible for the establishment of a Consumer Arbitration Panel including the recruitment, orientation and assignment of arbitrators.

The list of Panel members compiled by the NCDS-AAA shall be submitted to the Joint Policy Committee for its approval as well as new members recruited from time to time. It is imperative, however, to the integrity and impartiality of the arbitration process that arbitrators remain free from any direct control or undue influence by either business or consumer groups.

Panel members shall be selected on the basis of competency, integrity and objectivity and may be removed from the Panel for lack of any one of these qualities upon the motion of representatives of the PLCP, the PRA or the NCDS-AAA.

Participating organizations are free to nominate individuals to serve on the Consumer Arbitration Panel.

VIII. ARBITRATOR'S FEE

The NCDS-AAA shall undertake to recruit competent arbitrators for the Consumer Arbitration Panel. Whether competent arbitrators in sufficient numbers can be induced to serve with little or no compensation is indeed prob-

lemmatical. It is more likely that such arbitrators could be recruited at a considerably reduced fee on an occasional basis provided lengthy briefs are not submitted nor full opinions required with the issuance of the award. For example, the arbitrator under the circumstances mentioned above might agree to conduct hearings for a half day (four hours) per month completing possibly two or three cases and accept \$50 for the four hours of hearings. Even so, he would be donating study time, the time taken to write his award and whatever expenses he might incur in connection with the hearings. The NCDS-AAA believes qualified arbitrators can be recruited for the Panel on the basis outlined above.

IX. APPOINTMENT OF ARBITRATORS

Arbitrators shall be appointed by the NCDS-AAA from the previously approved list of Panel members.

X. ADMINISTRATION OF THE ARBITRATION PROCESS

The distinction between administering the arbitration process and the policy-making and other program functions of the Joint Policy Committee, as set forth herein, should be clearly understood and accepted. Just as arbitration is an impartial dispute settlement technique, the process by which it is administered must also be impartial. As a nationally accepted impartial administrative organization, the NCDS-AAA would administer the arbitration process and train and supervise staff involved in such administration. Physically locating this operation in either the PRA office or that of the PLCP has several drawbacks. Even if these difficulties could be substantially overcome, it is far more desirable to locate this particular operation on neutral ground and budget accordingly.

The NCDS-AAA is willing at the outset to absorb a major share of the cost of administering the arbitration service by reducing the administrative fee to \$25.00 per case to be borne equally by the consumer and the vendor.

XI. CERTAIN MAJOR ASPECTS OF THE ARBITRATION PROCESS

Each party to a consumer dispute submitted to arbitration must sign a Submission to Arbitration form agreeing that the decision of the arbitrator is final and binding and enforceable in accordance with the laws of the State of Pennsylvania.

Each party shall be entitled to a representative of his own choosing in hearings held before the arbitrator.

Matters of a highly unique nature and those calling for a high degree of technical expertise should be developed through appropriate witnesses.

XII. FUNDING

The budget finally approved for the pilot project shall be based on twelve (12) months of operation. It shall also be based upon the concept that 50% of the total cost should be obtained from business users and their associations and 50% of the total cost should be obtained from consumer users and their organizations except that the consumer share of the cost may be reduced or offset by contributions from foundations and community interest groups. Such reduction or offset shall not apply normally to payment of the case administration fee.

The budget will include the following items:

- (a) Personnel,
- (b) Office facilities,
- (c) Office equipment,
- (d) Consumable supplies,
- (e) Arbitrators' fees and expenses,
- (f) Travel,
- (g) Training programs,
- (h) Administrative fees.

XIII. THE CONSUMER ARBITRATION SERVICE IS A NON-GOVERNMENTAL PROGRAM

The Pennsylvania Consumer Arbitration Service is a private, non-governmental, non-profit operation and its program shall remain completely free of governmental influence, pressures and involvement except that individual cases may be referred to it by governmental units.

APPENDIX B

SUMMARY OF FACTS AND ISSUES—GROSSMAN V. PLAYBOY CLUBS INTERNATIONAL

The case of *Marshall B. Grossman v. Playboy Clubs International* a class action on behalf of Mr. Grossman and some 460,000 other holders of a Playboy Club "key" was begun on April 14, 1966.

The suit, one of seven similar class actions against Playboy, was commenced shortly after the Club announced it would institute a \$5 Annual Account Maintenance Charge to Playboy Club keyholders. Mr. Grossman, a Los Angeles attorney, alleged that the imposition of such an annual charge was in violation of the contract between keyholders and the Club, which involved what the keyholders believed was a one-time-only fee for membership.

On July 24, 1968, the Superior Court of the State of California for the County of Los Angeles approved a settlement between the parties. At that time, four of the seven lawsuits against Playboy Clubs had been decided in the defendant's favor.

By the terms of the settlement, which was finally approved in October 1969, the 460,000 keyholders each received "purchasing power credentials" worth a total of \$8.00 (a total of \$3,700,000) when presented in a Playboy Club. Mr. Grossman's law firm, which acted as plaintiffs' counsel, received a fee of \$275,000, plus expenses of \$3,000. Another law firm involved as counsel for some of the plaintiffs received fees totaling \$20,000 and expenses of \$2,000.

Credentials redeemable by Playboy Club keyholders are valid through October 10, 1971. Court supervision of the class action continues through January 8, 1972.

APPENDIX C

SUMMARY OF FACTS AND ISSUES—DAAR V. YELLOW CAB CO.

A settlement in the *Daar v. Yellow Cab Co.* case was finally agreed to on November 23, 1970 in Superior Court of California.

The court phase of the case began on November 20, 1964, when Los Angeles attorney David Daar, in behalf of himself and all other persons similarly situated, sued Yellow Cab Co. of California to recover as damages overcharges allegedly made by the company for taxicab services furnished to the plaintiff and other members of the class during the four years immediately preceeding the action.

The Superior Court dismissed the action on January 28, 1965, holding that it was not a proper class action. The State Court of Appeal upheld the trial court's view. However, the State Supreme Court, on November 28, 1967, overruled the lower courts and remanded the case for trial.

Negotiations for a settlement were begun shortly thereafter. On October 19, 1969, a settlement was reached, but the Superior Court judge involved refused to approve the agreement—providing for a \$90,000 a year reduction in taxi fares over a 10-year period, and attorneys' fees of \$450,000—because the attorneys' fees, to Mr. Daar and his partner, were too high.

The settlement approved on November 24, 1970—more than six years after the commencement of legal action—provides for a total reduction in taxi fares of \$1.2 million spread over 7½ years. In addition, Mr. Daar and his partner will receive legal fees totaling \$200,000, at the rate of \$25,000 per year.

Senator Moss. I must leave, so Senator Hart will be the chairman. If you will take over at this point, I would appreciate it very much.

Senator HART (presiding). I should indicate, if Senator Moss has not, that the full committee of Congress has, since these hearings were scheduled, scheduled an 11:30 a.m. executive session to consider—I am not sure what—something which is either to help or hurt the Railpax, and I will be obliged to recess at 11:30 a.m. I apologize to all of you for the inconvenience that causes, but it is the way the machinery works, or doesn't work, around here.

Our next witness is the general counsel for the Gas Appliance Manufacturers Association, Mr. Thomas Nichol.

VOICE. I wonder if you could tell us the probable schedule for later in the day for other witnesses?

Senator HART. Don't you remember when somebody asked you when the mail would get through?

I know what that does to a lawyer or businessman's schedule.

Let me suggest this: For those who find that the uncertainty as to a time when we would resume creates such difficulty, may I suggest that they consider filing a statement for the record to be printed in full?

I realize that is unsatisfactory and—well, my hunch would be that the committee would sit for an hour. I would think the recess would run at least until 12:30 p.m. And any of the witnesses whom we do hear, if they are able to summarize, it would help not only the committee but others similarly situated as witnesses.

STATEMENT OF THOMAS NICHOL, JR., GENERAL COUNSEL, GAS APPLIANCE MANUFACTURERS ASSOCIATION, INC.

Mr. NICHOL. I will do my best, Senator, to summarize in view of the pressure of time.

Without introducing myself further, I state that I am Thomas Nichol, Jr. I am a member of the New York Bar and I am general counsel for Gas Appliance Manufacturers Association.

The activities of that association and its membership are described in my statement.

At the outset, I would like to make it clear that we are concerned about protection of consumers, and if we find consumer class actions not to be the solution, this does not mean that we are heartless with regard to what consumers need.

Some might assume that because we are an association of manufacturers we would automatically oppose anything which might present stricter requirements for our members in the conduct of their business and sale of their products. This is not true.

We have already taken a position before this committee in favor of warranty legislation and have offered our suggestions toward the improvement of the pending bill and toward avoidance of certain possible consequences which we believe would make it partially unworkable and in several respects seriously inequitable.

In addition, we appeared yesterday before the Subcommittee on Legislation and Military Operations of the House Committee on Government Reorganization and presented our views in favor of the establishment of an independent agency within the Government for the protection of consumers' rights.

In approaching the problems of consumers, I suggest that our tasks are rendered considerably more difficult and complicated by the degree to which the entire matter is charged with emotions. That this should be the case is probably understandable. But I submit that if the problem is one charged with emotions, we should take care that the solution is not dictated by emotions.

There seems to be prevalent in the minds of many the idea that the consumer class action is the solution for the consumer's problems, the panacea for most of his ills—a device for obtaining speedy

and inexpensive redress and revenge against the supplier who is uniformly considered to be evil in the eyes of the consumerist.

If you wish to do something for consumers along these lines, we suggest that it should be something useful, workable, practical, and fair.

We do not think the consumer class action is the solution.

While class actions have been around for a long time, it is only in the last few years that they have attained prominence, and we believe that this has arisen more because of their spectacular and explosive effect than because they are a fair and convenient procedural device.

Is the consumer really going to get all the consumerists are telling him he will get—speedy, convenient and inexpensive redress? We think not. We do not believe in general that class actions are speedy, and where the defendant decides to defend himself instead of offering to settle, the case is apt to go on for a long time.

My statement cites the case of *Eisen v. Carlisle & Jacquelin* which has already been discussed this morning, so I won't mention it again.

Under class action procedures, anyone who has—or thinks he has—a claim typical with those which others have—or which he elects to think that others have—can designate himself representative of the class which may be almost unlimited in size, as evidenced by a number of such actions instituted in the last few years—for example, “all people of the United States, not only of this generation but of those generations yet unborn,” or “all record owners of new housing units of four families or less built in the United States during the period 1962-66.”

All members of these classes become plaintiffs and remain such unless they actually receive notice of the suit and take affirmative action to opt out. These are people who are not plaintiffs because they necessarily want to be, but merely because someone set in motion a suit in which they now find themselves getting a free ride. If they do not have to do anything about it, the chances are they will not. And the chances are that many or most of them will not share in the benefits of any judgment or settlement coming out of the suit.

A defendant who finds 1,000 or 10,600 or 500,000 plaintiffs arrayed against him—even if most of them are passive—cannot help but view his problem as formidable from sheer size alone.

Regardless of whether he may be guilty or innocent of the unfair consumer practice charged against him, he must be prepared to meet the potentially destructive effect of the accompanying publicity.

The commencement of a massive class action seems to have news value, as suggested by some of the clippings presented to your committee in the class action hearings a year ago. If we read that ABC Co. or XYZ Co. has been sued by 50,000 of its customers we are likely to conclude that it must have done something very wrong and that we had better not buy its products. This takes place before any decision on whether the claims of the 50,000 are meritorious or not.

And, apart from the adverse publicity, the defendant must realize that whether all—or any—of these plaintiffs have a valid claim is

something which may not be determined until considerable time has passed and considerable legal fees have been expended.

So what should the average defendant do when faced with a massive, unwieldy and costly litigation? It seems obvious that one of the first things to do is to think seriously about trying to settle and come out alive.

We are all aware that many lawsuits are settled in order to avoid the normal expense of contesting them, and we are all aware that many lawsuits are started or threatened in the hope that they will be settled for that reason. It seems reasonable to regard the class action as one which offers unusual leverage and advantage to the plaintiff in this regard.

It might be significant that two of the bills considered today contain provision that the consumer class action "shall be administered, as far as possible, to facilitate voluntary settlements." Possibly this or similar language appears elsewhere in the Federal statutes, but I must confess I do not recall it.

At any rate, its presence here might be construed as a recognition that a class action is going to be expensive for the defendant if he elects to contest.

Since settlement in a damage suit normally involves some consideration moving from the defendant to the plaintiff, the quoted language might be viewed by some as suggesting that the policy of the legislation prejudices the defendant to be probably liable and advises him to settle. I do not think that such was intended by the framers of the bills, yet I believe that some people may find these provisions worrisome.

Assuming a defendant is anxious to make an immediate settlement and hopefully avoid additional expense, two of the bills specifically provide that the cost of communicating the offer to the class shall be borne by the defendant. This appears to apply even though the offer might be beneficial and acceptable to the plaintiffs and in fact accepted by them.

Since the class may number in the thousands or hundreds of thousands, or millions, the cost of communicating the offer by mail or by newspaper advertising in various parts of the United States may be in itself a formidable sum.

Also, this would seem to rob the defendant of the normal freedom of settlement negotiations and put pressure on him to make an offer so good that it must surely be accepted, since if it is not, he may find himself paying the bill for communicating the next and subsequent offers also.

The purpose of the consumer class action is, of course, to provide recourse for the consumer, so let us see what may happen to some of the money paid by the defendant in settlement or pursuant to judgment.

The amount paid presumably bears some relation to the size of the class—in other words, the amount will be larger if the class is 500,000 than if it is 500. This is money paid to compensate the plaintiffs composing the class. Their existence thus contributes to the size of the fund, but they do not necessarily benefit from it. In fact, the legislation would contemplate that some do not.

Both S. 984 and S. 1378 provide that the prevailing consumer "shall be allowed, in addition to damages, the cost of the suit, including attorneys' fees" and that such costs may be awarded from damages "which the defendant owes to members of the class who cannot be located with due diligence."

Thus the bills recognize that there are going to be plaintiffs who cannot be found. They do not, however, contain what would seem to be a logical and reasonable provision that where a plaintiff has not bothered to come forward and cannot be found, the defendant should be relieved of paying damages to or because of him.

In the hearings last year a lawyer who presented enthusiastic testimony in favor of class actions gave an interesting insight into what happens to some of the defendant's money paid as damages or in settlement. With regard to certain antibiotic cases in which he was active he said:

We worked out a device whereby it was assumed that everyone who did not opt out of the class and did not file a claim, assigned his claim to the State or city of which he was a resident. And most of the money in that settlement will actually be paid to the States or to the cities, who can then use the money for health or other purposes.

If money paid by defendants in consumer class actions is to be used for the benefits of the public—for other purposes—perhaps street paving—rather than for the compensation of damages allegedly suffered by the consumer plaintiffs, the proceeding becomes in substantial effect one of levying a fine on the defendant.

And, if that is the purpose, we submit that the matter would better be placed in the hands of the public agencies or officers authorized to prosecute. If a defendant finds himself opposed by the Department of Justice or the Federal Trade Commission, he at least knows that he is dealing with lawyers who are performing a public duty and are not influenced by how large a fee they can get out of the case nor in search of publicity which may hopefully bring them more class action plaintiffs.

Senator, instead of proceeding with my statement, I see that the time grows short. I think I should now offer to answer your questions, if you wish.

Senator HART. Thank you for your thoughtfulness and your consideration. I think I have no questions.

No one on the committee is unmindful of the adverse effect that publicity reporting a substantial class action filed against the ABC Co. would have, and it is no comfort to the ABC Co. that that is the same thing that happens to them if they have a stockholder action against them. But, in any event, notwithstanding the adverse publicity, our problem is to respond also to the individuals who may, in fact, have been deceived by the ABC Co., lost their money and have nothing to show for it.

Mr. NICHOL. Senator, I think that the people whom I represent are very much aware of their problem and very much aware of what a difficult situation we face. The class action is having a bear by the tail, I think. I think we are very much aware that the consumer needs help and protection, and our position is that this explosive device is not the best help to give him because of its difficulties and its fallout.

Senator HART. Thank you very much.

Mr. NICHOL. Thank you, sir.

(The statement follows:)

STATEMENT OF THOMAS NICHOL, JR., GENERAL COUNSEL, GAS APPLIANCE MANUFACTURERS ASSOCIATION, INC.

My name is Thomas Nichol, Jr. I am a member of the New York Bar and am General Counsel for Gas Appliance Manufacturers Association, frequently called GAMA. We are a national trade association of manufacturers who produce a wide variety of gas appliances and equipment, including ranges, water heaters, clothes dryers and incinerators, as well as gas equipment for industrial purposes. Our members also manufacture components for all of these products, such as valves, pressure regulator, various types of controls and the like. Our members number over 500, and they produce in the neighborhood of 90% of the gas appliances and equipment manufactured in the United States.

We are concerned today with three bills, S. 984, S. 1378 and S. 1222, all of which are designed to provide for a class action by consumers. All three establish a cause of class action where the consumer has been hurt by an "unfair consumer practice," and all three recite a number of acts which will constitute an "unfair consumer practice." They differ in some degree as to just what acts shall give rise to class action, but by and large the "unfair consumer practices" listed include those which the Federal Trade Commission has found improper in its several guides against deceptive advertising practices. "Unfair consumer practices" do not stop there, but in some instances are expanded by omnibus-type language apparently intended to pick up everything not specifically listed.

At the outset let me make it clear that if we find the proposed consumer class action an unsatisfactory solution, this does not mean that we oppose adequate and proper protection for consumers. Some might assume that because we are an association of manufacturers we would automatically oppose anything which might present stricter requirements for our members in the conduct of their business and the sale of their products. Not true; we have already taken a position (before this Committee) in favor of warranty legislation and have offered our suggestions toward the improvement of the pending bill and toward the avoidance of certain possible consequences which we believe would make it partially unworkable and in several respects seriously inequitable. In addition, we appeared yesterday before the Subcommittee on Legislation and Military Operations of the House Committee on Government Reorganization and presented our views in favor of the establishment of an independent agency within the government for the protection of consumers' rights.

In approaching the problems of consumers, I suggest that our tasks are rendered considerably more difficult and complicated by the degree to which the entire matter is charged with emotions. That this should be the case is probably understandable. But I submit that if the problem is one charged with emotions, we should take care that the solution is not dictated by emotions.

There seems to be prevalent in the minds of many the idea that the consumer class action is the solution for the consumer's problems, the panacea for most of his ills—a device for obtaining speedy and inexpensive redress and revenge against the supplier, who is uniformly considered to be evil in the eyes of the consumerist.

If you wish to do something for consumers along these lines, we suggest that it should be something useful, workable, practical and fair.

We do not think the consumer class action is the solution.

While class actions have been around for a long time, it is only in the last few years that they have attained prominence, and we believe that this has arisen more because of their spectacular and explosive effect than because they are a fair and convenient procedural device.

Is the consumer really going to get all the consumerists are telling him he will get—speedy, convenient and inexpensive redress? We think not. We do not believe in general that class actions are speedy, and where the defendant decides to defend himself instead of offering to settle, the case is apt to go on for a long time. An oft-cited example is the case of *Eisen v. Carlisle & Jacquelin* in the Southern District of New York. This case, brought on behalf

of a class estimated at 3,750,000 persons by a plaintiff whose damages are estimated at \$70, was commenced in 1966. Since then it has twice been in the Circuit Court of Appeals, but so far there has not been a trial on the merits and one of the class of plaintiffs has enjoyed speedy recovery or redress.

Under class action procedures, any one who has—or thinks he has—a claim typical with those which others have—or which he elects to think that others have—can designate himself representative of the class which may be almost unlimited in size, as evidenced by a number of such actions instituted in the last few years—for example, “all people of the United States, not only of this generation but of those generations yet unborn” or “all record owners of new housing units of four families or less built in the United States during the period 1962–1966.” All members of these classes become plaintiffs and remain such unless they actually receive notice of the suit and take affirmative action to opt out. These are people who are not plaintiffs because they necessarily want to be but merely because someone set in motion a suit in which they now find themselves getting a free ride. If they don’t have to do anything about it, the chances are they will not. And the chances are that many or most of them will not share in the benefits of any judgment or settlement coming out of the suit.

While the plaintiffs are getting a free ride, what is the defendant doing?

A defendant who finds 1,000 or 10,000 or 500,000 plaintiffs arrayed against him—even if most of them are passive—cannot help but view his problem as formidable from sheer size alone. Regardless of whether he may be guilty or innocent of the unfair consumer practice charged against him, he must be prepared to meet the potentially destructive effect of the accompanying publicity. The commencement of a massive class action seems to have news value, as suggested by some of the clippings presented to your Committee in the class action hearings a year ago. If we read that ABC Company or XYZ Company has been sued by 50,000 of its customers, we are likely to conclude that it must have done something very wrong and that we had better not buy its products. This takes place *before* any decision on whether the claims of the 50,000 are meritorious or not. And apart from the adverse publicity, the defendant must realize that whether all—or any—of these plaintiffs have a valid claim is something which may not be determined until considerable time has passed and considerable legal fees have been expended.

So what should the average defendant do when faced with a massive unwieldy and costly litigation? It seems obvious that one of the first things to do is to think seriously about trying to settle and come out alive. We are all aware that many lawsuits are settled in order to avoid the normal expense of contesting them, and we are all aware that many lawsuits are started or threatened in the hope that they will be settled for that reason. It seems reasonable to regard the class action as one which offers unusual leverage and advantage to the plaintiff in this regard. It might be significant that two of the bills considered today contain provision that the consumer class action “shall be administered, as far as possible, to facilitate voluntary settlements.” Possibly this or similar language appears elsewhere in the Federal statutes, but I must confess I do not recall it. At any rate, its presence here might be construed as a recognition that a class action is going to be expensive for the defendant if he elects to contest. Since settlement in a damage suit normally involves some consideration moving from the defendant to the plaintiff, the quoted language might be viewed by some as suggesting that the policy of the legislation prejudices the defendant to be probably liable and advises him to settle. I do not think that such was intended by the framers of the bills, yet I believe that some people may find these provisions worrisome.

Assuming a defendant is anxious to make an immediate settlement and hopefully avoid additional expense, two of the bills specifically provide that the cost of communicating the offer to the class shall be borne by the defendant. This appears to apply even though the offer might be beneficial and acceptable to the plaintiffs and in fact accepted by them. Since the class may number in the thousands or hundreds of thousands or millions, the cost of communicating the offer by mail or by newspaper advertising in various parts of the United States may be in itself a formidable sum. Also this would seem to rob the defendant of the normal freedom of settlement negotiations and put pressure on him to make an offer so good that it must surely be accepted, since if it is not, he may find himself paying the bill for communicating the next and subsequent offers also.

The purpose of the consumer class action is, of course, to provide recourse for the consumer, so let us see what may happen to some of the money paid by the defendant in settlement or pursuant to judgment. The amount paid presumably bears some relation to the size of the class—in other words, the amount will be larger if the class is 500,000 than if it is 500. This is money paid to compensate the plaintiffs composing the class. Their existence thus contributes to the size of the fund, but they do not necessarily benefit from it. In fact, the legislation would contemplate that some do not.

Both S. 984 and S. 1378 provide that the prevailing consumer "shall be allowed, in addition to damages, the costs of the suit, including attorneys' fees" and that such costs may be awarded from damages "which the defendant owes to members of the class who cannot be located with due diligence." Thus the bills recognize that there are going to be plaintiffs who cannot be found. They do not, however, contain what would seem to be a logical and reasonable provision that where a plaintiff has not bothered to come forward and cannot be found, the defendant should be relieved of paying damages to or because of him.

In the hearings last year a lawyer who presented enthusiastic testimony in favor of class action gave an interesting insight into what happens to some of the defendant's money paid as damages or in settlement. With regard to certain antibiotic cases in which he was active, he said:

"We worked out a device whereby it was assumed that everyone who did not opt out of the class and did not file a claim, assigned his claim to the State or city of which he was a resident. And most of the money in that settlement will actually be paid to the States or to the cities, who can then use the money for health or other purposes." Serial No. 91-48 p. 318.

If money paid by defendants in consumer class actions is to be used for the benefit of the public (for "other purposes"—perhaps street paving) rather than for the compensation of damages allegedly suffered by the consumer plaintiffs, the proceeding becomes in substantial effect one of levying a fine on the defendant.

And if that is the purpose, we submit that the matter would better be placed in the hands of the public agencies or officers authorized to prosecute. If a defendant finds himself opposed by the Department of Justice or the Federal Trade Commission, he at least knows that he is dealing with lawyers who are performing a public duty and are not influenced by how large a fee they can get out of the case nor in search of publicity which may hopefully bring them more class action plaintiffs.

No, the consumer class action is not the remedy. A great deal has been said about the extent to which the class action can lend itself to strike suits—despite the safeguards which the courts would impose. They have been described as a lawyers' paradise, and I need not go into detail as to why. What better situation for the unprincipled attorney than to represent a huge class of plaintiffs against a defendant who had better settle. I submit that provisions requiring the court to look into attorneys' fees in consumer class actions may fail to avoid the abuses we fear. In a large number of instances the courts take the lawyer's word for the amount of work he has done and time he has expended. I regret to say that some lawyers are adept in presenting an inflated description of the work done. I was recently involved in a matter in which one of the attorneys asked for approximately six times what I estimated to be an adequate compensation. Some of the parties objected, so the court gave the lawyer only four times (instead of six times) the amount I think would have been fair. We have all heard of the class settlement involving members of a Playboy Club. The members each recovered an \$8.00 chit which they might redeem over a period of two years. The attorneys are reported to have received \$275,000. I do not suggest that they did not earn it, but I stress that when one gets into class actions, one moves in the big money area. A few months ago a lawyer friend of mine told me that he feared he had a class action on his hands—in this instance a stockholders' suit. The next time I saw him I asked how it was progressing. Apparently it had not gone very far, because he said he had been able to settle it for \$15,600—\$600 for the plaintiff and \$15,000 for the plaintiff's attorney.

The bills before us all contain, as previously mentioned, a list of acts constituting unfair consumer practices. Admittedly, most of these are things which most self-respecting business people would not even consider—for ex-

ample, using physical force against a consumer or failing to refund a deposit made for goods not delivered. But it is not quite so simple as that. First, the size, momentum, unwieldiness and publicity of even a class action based on reckless and irresponsible charges is something to be feared, since a lot of mischief may be done before vindication—assuming that the matter is not settled sooner. Second, S. 984 provides that cause for a consumer class action arises from, in addition to the specified acts, “any other act or practice which is unfair or deceptive to a consumer and is prohibited by section 5(a)(1) of the Federal Trade Commission Act . . .”

This looks reasonable enough, and one can not very well argue that a supplier should not be answerable for his unfair, deceptive and illegal acts; however, a practice may be in violation of the statute for a long time before the Commission proceeds against it. An example is the famous case of “Carter’s Little Liver Pills.” The pills had been advertised and sold as such for over half a century before the Federal Trade Commission proceeding which culminated in the determination that they could no longer be so described because it was decided that they did little or nothing for liver problems. In such a situation should a consumer who knew an opportunity when he saw one be entitled to start a class action against Carter Products, Inc. on behalf of all the persons—and I imagine they were numerous—who had bought the pills in the preceding half century or—if the statute of limitations contained in section 102(e) of the bill applied, which I submit is not certain—on behalf of those who had bought the pills in the preceding three years? I recall seeing mention of a Federal Trade Commission proceeding some years ago in which the seller of a domestic tobacco pipe was prohibited from calling it the “Park Royal” because some one might be misled into thinking it was imported from England. In this matter I find it hard to view the possible deception with the same seriousness as the Commission did, but I respect its decision. Should this type of situation give rise to a consumer class action? I submit that it should not and that such would be killing a sparrow with a blunderbuss.

I submit that it should not because I find it difficult to attribute to the seller of the pipe or the lesser of the pills a real evil intent. It seems plain to me that we are considering legislation which, in its apparent desire to do something for the consumer and to give the supplier a hard time, fails to make any distinction between the inadvertent and the evil. A supplier against whom a massive class action is brought has got to think about the possibility of settlement to avoid being run over, and a decision on the merits seems to lose importance. If a supplier does something really evil whereby the consumer is hurt, the supplier should be punished, but I suggest that tossing him into class actions where intent may get lost or at least moved to second place, is not the answer.

Nor can I believe that the suppliers who are the true offenders as to the type of unfair practices exemplified in the lists contained in the bills are going to be reached. They are the fly-by-nights, the slick operators and they are probably judgment proof insofar as a class action is concerned. Is it not going to be far more rewarding for plaintiffs and lawyers to try to find some complaint against the well-established and successful supplier who can afford to pay damages or make a worthwhile settlement? I do not contend that no well-established or successful supplier is ever guilty of an unfair trade practice, but if we are going to correct wrongs, let’s attack where the most wrongs are.

I have not gone into detail regarding the provisions of the several bills we are examining because I am convinced that they all contemplate a wrong remedy. The question of consumer class actions is highly controversial, with strongly held views on both sides. Such views have been expressed both before your Committee and elsewhere by men whose reputation and ability precluded the presentation of hastily considered or biased views. We mentioned to you last year—and I take the liberty of reminding you again—that the former Chairman of the Federal Trade Commission, Casper Weinberger, described the class action remedy as “an invitation to legal blackmail.” The same term has been used by Milton Handler, a prominent member of the New York Bar and a professor of law at Columbia University.

The class action is an explosive type of remedy which by its very nature can—as demonstrated—become a monster. It contains a potential chain-reaction which can easily distort its basic purpose of applying a fair and

equitable compensation or a fair and equitable protection—always based on a finding of truth. We have mentioned the wide segment of opinion which holds that its expansion in this area is undesirable and that it is not a proper remedy to be turned loose for possible exploitation by opportunists and hungry lawyers under the banner of aiding the consumer. If the courts and remedies which are now available to the consumer are deemed inadequate, we recommend that existing agencies such as the Federal Trade Commission be given adequate powers and adequate funds to protect him.

We believe that opening up the class action to consumer claims will cost the nation more in misuse, abuse, delay and exploitation than all the benefits which this remedy will possibly provide.

Senator HART. We are at 11:30, and this being the hour at which the full committee is meeting, under our rules the subcommittees are not permitted to meet.

I add that just in case you thought it was because I was interested in Railpax.

There are five, I am advised, who are scheduled to testify.

The committee will recess, to resume the hearing at 2 p.m.

(Whereupon, at 11:30 a.m., the subcommittee was recessed, to reconvene at 2 p.m., this same day.)

AFTERNOON SESSION

Senator HART. The committee will be in order.

Resuming this afternoon, our first witness representing the Association of Home Appliance Manufacturers, assistant general counsel to Maytag, is Mr. Donald C. Byers.

STATEMENT OF DONALD C. BYERS, ASSISTANT GENERAL COUNSEL, MAYTAG CO., REPRESENTING THE ASSOCIATION OF HOME APPLIANCE MANUFACTURERS; ACCOMPANIED BY GEORGE P. LAMB, GENERAL COUNSEL

Mr. LAMB. Mr. Chairman, I am George P. Lamb, general counsel of the Association of Home Appliance Manufacturers; and I want to introduce Mr. Byers. It is a policy of the association to have accompanying lawyers, if possible, or representatives of the company of the industry to come and offer their views on legislation of this importance, and I am very pleased to present Mr. Byers.

Senator HART. Thank you. We are glad to have you here, Mr. Lamb.

Mr. Byers, Mr. Lamb does make clear to us the views of the Association when no one else comes in.

Mr. BYERS. Mr. Chairman, just by way of background, I might say I have spent most of my professional career with my company, and during these some 18 years I have had substantial responsibility in dealing with consumer problems. This has included participation in consumer related activities within my company, contact with Government agencies, and dealings with members of the practicing bar.

As has been stated, my appearance today here, however, is as a member of the Government committee of the Association of Home Appliance Manufacturers. This afternoon I will provide a summary

of the more detailed statement which has already been delivered to the committee. Then, of course, at the conclusion I would invite your questions, if you have any.

As you may know, our association, commonly called AHAM, has previously appeared before this committee to provide testimony on consumer protection. To the extent that proposed legislation deals with strengthening the Federal Government's hand in detecting and curbing fraud and deception we support it. At the same time we have and do oppose legislation that would unleash the power of the plaintiff's bar in unrestricted class actions against American American businessmen in general.

You may ask, because class actions are so abhorrent to business, whether this is a certain indication of their desirability as redress for consumers. We think not, for in most instances the real party in interest will be the attorney because of the prospect of a large legal fee rather than the consumer who will generally be entitled to recover only minor amounts of money. If the consumer's loss is significant, he has available to him local remedies that are far more efficient and rapid than a class action.

The concern, or perhaps I should say fear, of the unrestricted class action at the Federal level is that enterprising attorneys will exploit the opportunities made available to the detriment of the business community. Other witnesses have written this off as an unjustified concern because of the judicial discretion permitted by rule 23. I submit that this provides little consolation when considering the substantial sentiment for the little guy in litigation in our courts.

I have had plaintiffs' attorneys tell me, and with good reason: "I don't really care what the facts are. If I can get to the jury, I will collect something from my client." Our general experience has been it is a rare judge who will not let a case go to the jury today.

Another example of plaintiffs' attorneys' legal fishing license is in the broad and poorly defined area of the antitrust laws. My company was involved in a conspiracy count under section 1 of the Sherman Act as one of some 26 defendants. The litigation spanned a period of 8 years and during that time a considerable number of the defendants settled on the ground that it was cheaper to do so than defend, leaving only about eight to fight it out to the bitter end. We ultimately obtained a directed verdict at the close of plaintiff's case, but only after the investment of well over \$100,000 in the defense and many hundreds of hours of time by our own company officials.

I might add parenthetically at this place this was in spite of the fact that the judge almost from the inception believed and understood and indicated in many ways he thought it was a groundless suit, but he felt constrained to permit it to go the length it did.

I would reiterate what you have heard other witnesses time and time again say. The remedy of class actions under rule 23, without the restrictions of diversity of citizenship and the \$10,000 requirement for each individual claim, does present a very real threat of harassment to businessmen. Even this would not be quite so bad if the experience to date under rule 23 was not so cloudy and therefore

subject to substantial doubt of its value as a legal tool. I know you are aware that the judiciary has at best a very cautious attitude concerning the appropriateness of the class action to more than a very few select situations.

I think the proponents of consumer legislation may have underestimated the corrective influence the new forces in the marketplace are exerting and what further strengthening of government agencies will accomplish without the onerous class action remedy. It is clear from my vantage point that corporations are deeply aware of what is expected of them and have broadened their understanding of consumer needs. They have instituted programs that are bringing them closer to consumers. There has been legislation at the local level speaking to consumer concerns. Governmental agencies, both at the State and Federal levels, have created or stepped up their activities in this area. Thus it would seem appropriate to have now a period of time in which to consolidate the gains from these new emphases and see what further may be needed after evaluation.

Let me build for a moment on the idea that we do not feel class actions will solve the grievances which were made known in the hearings on S. 3201. In Senate Report 91-1124 those grievances included expenditures on worthless drugs, deceptive magazine practices, fraudulent practices in making home repairs and repairing television sets. Because it is our belief the consumer is interested in very rapid redress for problems of this sort, we think much better solutions are to be found in voluntary industry programs, increased governmental activity at the local level and by improvements in the small claim court procedure and availability.

As an example of a voluntary industry program, AHAM has had in operation for a number of years a complaint procedure that operates in addition to the efforts of individual companies. Between March 1968 and March 1971 AHAM has processed 2,889 complaints. A total of 1,855 of those complaints were settled and 991 are still pending. Of this entire group only 43 were considered as impossible to resolve. AHAM has a vehicle for an independent audit of this complaint exchange through an organization known as the Major Appliance Consumer Action Panel, commonly referred to as MACAP, which is headed by Dr. Virginia Cutler of Brigham Young University. This program has proved to be highly beneficial to the consumer.

Local and State agencies to handle consumer problems or to obtain redress can be created and/or strengthened. In my own State of Iowa the Consumer Protection Division of the Attorney General's Office handled 523 complaints in 1967, and by 1970 this number had swelled to 1,883. The amount recovered for consumers in 1970 was \$324,881, and a recent report shows a single month high of \$90,000 in March of this year.

These latter figures are not spectacular when compared to the \$1,450,000 reported as being recovered in 1969 in the State of New York, but it must be remembered the State of Iowa has a population of less than three million. These statistics from Iowa demonstrate, however, that increasingly effective remedies for consumers are being applied by individual States.

The judicial forum in which the practices detrimental to consumers should be enjoined and consumer complaints settled are courts of limited jurisdiction, usually referred to as small claims courts. There are, I believe, indications that these courts have on their dockets a growing number of consumer suits for the recovery of small dollar amounts. To illustrate, in the fiscal year 1969-70, the municipal court for the city of Chicago alone had nearly 72,000 small claims filed which are defined as involving \$200 or less. Other large cities could provide similar indications of use by citizens of local courts.

In addition, efforts are being made to improve the quality of courts handling such claims. In Iowa, for example, the Senate has approved a bill to abolish the office of justice of the peace and create a unified court system through our district courts. The judges of these courts of record would in turn appoint magistrates to preside over the claims of relatively small amounts. If passed by both Houses of the legislature, this will give the State more effective and efficient local courts to deal with consumer complaints.

Now that I have described something of the viability of local programs aimed toward consumer relief, permit me to say a little about the specific language of the bills under consideration. I would observe the broad and vague nature of some of that language would permit plaintiffs to bring class actions in areas which previously were never regarded as unfair methods of competition. Section 101(1)(P) of S. 984 prescribes against any other act or practice which is unfair or deceptive to a consumer and is prohibited by Section 5(a)(1) of the Federal Trade Commission Act.

This is of such a general nature that no national advertiser would dare make a representation without a full realization that advertising itself is suspect and could be regarded as unfair. In many cases which were previously regarded as mere "puffing," today more and more such claims are being challenged by the FTC and, everything considered, perhaps not inappropriately.

This everchanging judgment as to what is an unfair or deceptive act or practice under section 5 should not, however, become the basis for consumer class actions because of its unpredictability. In the absence of any real damage to consumers, regulation should not be achieved by private class actions but instead should be handled by a government agency such as the Federal Trade Commission acting in the public interest.

In conclusion permit me to observe that in recent years disadvantaged people have been led to look more and more to the courts to settle their problems both as groups and individuals. Litigation inevitably sets these people against business and develops each into antagonistic groups. At this point in our history we do not need legislation that would make our citizens even more "litigious." We should instead concentrate on the development of procedures to deal with and dispose of the issues promptly and equitably before they become serious problems and before the parties find it necessary to turn to litigation.

In other words, we should attempt to make the courts places of last resort. The enactment of a class action remedy as proposed

would, I am convinced, work in the opposite direction. We strongly urge the subcommittee to reject class actions in reporting to the full committee, and I might add proposing something in the way of a remedy that might be more effective than we think class actions are.

Senator HART. Thank you very much.

I am not familiar with how many States do have class action statutes, but Maytag distributes very widely in this country. Has your company had experience in any of the States where class actions are available?

Mr. BYERS. We have never had filed against us a class action procedure. Frankly, we haven't had many lawsuits of any kind filed against us.

Senator HART. Well, the class action statute has not been exploited by attorneys in the States you market in.

Mr. BYERS. Not to my knowledge. As I said, I have had no experience, but then as we say, or I would say now that the range of those class actions statutes would be significantly different than in the case of the proposed Federal legislation.

Senator HART. From the standpoint of the consumer, those class action statutes are less effective; is that the way the consumer would put it?

Mr. BYERS. Pardon me?

Senator HART. Could I translate it by saying then the transactions that you are familiar with in those States where they do exist are less effective than the proposal now before us?

Mr. BYERS. Sir, I don't think there has been a great amount of activity with class actions at the local level, and I think part of it, as you may very well know, has to do with the questions of judicial problems of recognizing them as being appropriate remedies. I think our testimony is that probably there are better local remedies available than class actions which may very well explain your question in a sense.

Senator HART. You do counsel us against enacting a Federal class action?

Mr. BYERS. Yes, that is our position.

Senator HART. Do you counsel State legislatures against enacting State class action proposals?

Mr. BYERS. Not necessarily.

Senator HART. Do you encourage it?

Mr. BYERS. I don't know that our association has taken a position. Frankly, as a person and as a company, I don't see these as broad bases for relief to consumers, no.

Mr. LAMB. Senator, may I make a comment on that?

Senator HART. Mr. Lamb.

Mr. LAMB. It seems to me that in the last several years the class action legislation has had a lot of glamour around it, and it seems to me that we pointed out time and time again that we do not think that is the solution to the problem of the consumer. I feel for the benefit of those who are promoting this kind of legislation as well as those of us who are opposing it that there ought to be a study made in depth by the judicial conference.

It seems to me that there is so much trouble with rule 23 since it was amended in 1966 that the time has come when it would be desirable for either the Senate Judiciary Committee or the Judicial Conference on its own to make another study of what to do about that rule, whether they should tighten up the discretion—loosen up the discretion of the Federal judges, whether they should make it more difficult to bring these suits, or just what should be done about them.

I don't think that we are getting to the point in our hearings with regard to a real sound constructive solution. I sincerely recommend to you that this matter be put into the hands of the Judicial Conference for a study of the Federal judges.

Senator HART. Counsel reminds me that the courts, and I take it the Judicial Conference, spent a good many years revising rule 23. At the end of almost 10 years, they thought that the rule was in such form as to permit the courts to respond adequate to however you describe it, label it, an improper ambulance chasing kind of harassment.

Mr. LAMB. There is a distinct difference of opinion among plaintiff's lawyers and those who are opponents of class action legislation.

Senator HART. We will still have unreasonable consumers, but we won't have the problem to the degree we have it now if we can just market consumer goods which work all the time.

Agreed?

Mr. BYERS. The question of whether the degree of consumer problems and complaints really are totally justified is I think somewhat up for grabs. I think in terms of our company we have built our marketing and business reputation on delivering the consumers the dependability we think they are entitled to.

That doesn't mean to say that we don't have people who are unhappy and disenchanted, but by and large we get a better price for our product because people have assumed this. I think this is true of many, many products on the American market today, and I think we are greatly concerned that—and much of the testimony has gone in this direction—the fly-by-night operators have tended to drag us down in a sense to a lower level than we deserve.

Not so much that there aren't problems and we are certainly willing to address ourselves to those problems and to effect better procedures, but I think we should be very cautious about adopting procedures that we might say overcorrect and create, as we would say, more problems than they actually solve.

Senator HART. There is one sentence in your statement, and I ask the question only to clarify it. There you point out there is a catchall only to clarify it. There you point out there is a catchall segment of 101 that permits action for any other act or practice which is unfair or deceptive and is prohibited by the Trade Commission Act under section 5.

You then say:

This is of such a general nature that no national advertiser would dare make a representation without a full realization that advertising itself was suspect and could be regarded as unfair.

Would you clarify that a bit? Are you suggesting there is a feeling that advertising per se is unfair, or that—

Mr. BYERS. No, I think what we are trying to suggest is that all advertising is being examined very critically today in view of changing consumer attitudes, changing emphases, and what used to be acceptable advertising a few short years ago or even months ago may today be viewed by someone examining it, a new person with a new idea, may be deemed as being deceptive and misleading, and we are saying that if all of those things are in issue, then here we are subject to class action without really in advance having any track to run on or any information warning of what some person's interpretation of what unfair and deceptive advertising may be.

Senator HART. We could discuss that one for awhile, too.

Mr. BYERS. Mr. Lamb, did you have anything to add?

Mr. LAMB. No, I think—is the number 13 in the bill, now, 101 (13)?

Senator HART. (P).

Mr. LAMB. It seems to me you don't need all the rest of them if you have that one. I would recommend that you remove that from the bill.

Senator HART. It is the difference between the sign which says don't exceed 50 miles an hour and the sign that says drive reasonably. You have got a lead pipe notice up to the fellow who goes beyond 50, and you put everybody else on cautionary notice.

Mr. LAMB. Thank you very much, Senator.

Senator HART. Our next witness, speaking for the Consumer Bankers Association, is its First Vice President, Mr. W. C. Owens.

STATEMENT OF W. C. OWENS, FIRST VICE PRESIDENT, CONSUMER BANKERS ASSOCIATION, WASHINGTON, D.C.

Mr. OWENS. Mr. Chairman, my name is W. C. Owens. I am senior vice president of the North Carolina National Bank, as well as first vice president of the Consumer Bankers Association and chairman of its legislative committee.

The Consumer Bankers Association is a trade association comprised of over 230 commercial banks located in 29 States, the District of Columbia and Puerto Rico, which engage in providing installment loans to consumers. We estimate that our members administer more than 40 percent of all consumer credit outstanding at all commercial banks.

The association places emphasis on new fields of installment lending, new methods of operation and new approaches to management problems in the belief the installment lending function of a bank is the vehicle by which the bank more fully serves the needs of the community.

The individual banks who give life and identity to our association are specialists in consumer lending. Our primary objective is to improve the consumer lending function of commercial bank so that all responsible individuals seeking consumer credit will have the opportunity to benefit from the services offered by the commercial banking industry.

Such services include, but are not limited to, home mortgage loans, student loans, bank credit cards, automobile financing and other tra-

ditional extension of installment credit which have proven so useful to many millions of American consumers.

We are pleased to be afforded the opportunity to present our views on the class action legislation pending before the subcommittee.—S. 984, A. 1222, and S. 1378. The association strongly believes that the pervasive and specialized regulatory system governing all aspects of the operations of the commercial banking industry makes it necessary and desirable that any consumer class action legislation enacted by Congress contain an exclusion for banks and other financial institutions. We also believe that such legislation should make certain that the jurisdiction of the FTC is not inadvertently expanded in such a manner to cover banks and other comprehensively regulated industries which Congress, in its wisdom, has consistently excluded from FTC jurisdiction since the creation of the Commission in 1914. Finally, the association urges that any consumer class action legislation enacted by Congress should provide for the maintenance of such suits only upon the successful conclusion of an action by the FTC or the Department of Justice.

All three bills before the subcommittee, S. 984, S. 1222, and S. 1378, would, if enacted in present form, authorize classes or groups of consumers to institute legal proceedings against persons who commit an "unfair consumer practice," but since the bills are not identical, we would like to comment briefly on some provisions of each. But I will skip these legal and technical provisions during my presentation but ask that our prepared statement be inserted in the Record.

Senator HART. They will be used and printed in full in the record.

Mr. OWENS. I will go to the basis for what we think is a basis for banking exemption.

Banks are already subject to pervasive regulation by the States and the Federal Government. A bank, unlike most other suppliers of consumer goods or services, can obtain and retain its charter to engage in business only upon a finding that its operations are in the public interest. Every bank is subject to continuous and exhaustive supervision and examination by at least one, and often several, State or Federal bank regulatory authorities.

These authorities are given broad power under State law, the National Bank Act, the Federal Reserve Act, the Federal Deposit Insurance Act, and the Financial Institutions Supervisory Act to investigate any and all aspects of a bank's activities, through surprise examinations of each bank, and through the practice of requiring various reports of each bank's operations.

The various bank regulatory authorities also have sweeping power to correct abuses. They can issue cease and desist orders, remove bank officers and directors from their jobs, cancel a bank's deposit insurance, withdraw the privilege of Federal Reserve System membership, and even close and liquidate a bank where they find such actions necessary.

The basis and justification for this pervasive regulation is the special public and governmental interest in maintaining the stability and soundness of banks and in limiting the nature and extent of the risks to which banks and bank customers are exposed. While

there is no special public policy interest requiring protection of consumer goods producers against insolvency, the continued solvency and liquidity of banking institutions has long been regarded as vital to the functioning of the national economy in general and to the protection of bank depositors in particular.

In short, there are special public policy reasons to limit the risks to which banks are exposed. Banks are extraordinarily vulnerable to unmeritorious litigation. Banks are widely and popularly assumed to have the resources to pay substantial settlements and, because of their peculiar dependence upon the confidence of their customers, can generally ill afford the adverse publicity often generated by litigation.

Moreover, the Federal Government has a unique and vital interest in preventing any needless exposure of banks to unmeritorious yet potentially costly litigation. The great majority of bank depositors' accounts are insured by the Federal Deposit Insurance Corporation and the risk of bank insolvencies thus falls heavil yon the Government itself.

At the very least, legislation that may have the effect of encouraging or facilitating unmeritorious litigation against banks should be enacted only upon a clear showing of need.

No such showing has been made. In fact, in light of the extensive State and Federal regulation of banks, a class action remedy such as that proposed in the legislation before the subcommittee is simply unnecessary in the banking field. The State and Federal regulatory system under which banks operate already provides an infinite simpler, less expensive and more effective remedy for consumer grievances than the cumbersome class action device. Bank customers who have been treated unfairly by a bank can seek redress through at least one—and usually several—bank regulatory agencies.

These agencies are in a position to act promptly and efficiently on the basis of consumer grievances reported informally, often by telephone or letter. When a grievance is found to have merit, the bank is required by the regulatory agency to take immediate and full corrective action. No similar grievance remedy is available to customers of most other suppliers of consumer goods or services. The remedy available to bank customers—free, complete, and vastly more efficient than litigation—stands in striking contrast to the necessarily crude and unwieldly remedy of a consumer class action suit.

The limited exemptions contained in S. 984—the exclusion of “the providing of credit to the extent that credit is regulated under the Truth in Lending Act”—and in S. 1222—the exclusion of “credit services . . . to the extent that unfair consumer practices are prohibited with respect to these services under other Federal law or regulation”;—are inappropriately narrow in light of the far more comprehensive regulation to which banks are subject.

As noted above, the credit and lending activities of banks are subject not only to the disclosure provision of the Truth in Lending Act, but also to longstanding State and Federal regulatory statutes, as well as the rules and regulations promulgated thereunder.

The class action bills' exemption for banks should parallel and be coextensive with existing bank regulation. We suggest the reasoning

that led to the limited exemption that would be granted to banks under S. 984 and S. 1222, quoted above, actually justified a considerably broader exemption for the services provided by banks and we believe our views are shared by the bank regulatory agencies.

In correspondence to the chairman of the Committee on Commerce on September 30th and October 6th, 1970, Mr. Arthur F. Burns, chairman of the Board of Governors of the Federal Reserve System, and Mr. William B. Camp, Comptroller of the Currency, respectively, stated their positions on the class action legislation pending in the 91st Congress, S. 3201, the Consumer Protection Act of 1970. For the convenience of the subcommittee, we have appended copies of that correspondence to this statement and request that they be included in the record.

The Consumer Bankers Association acknowledges that the comments of the Board of Governors and the Comptroller are directed at legislation not being considered at this time, but we believe their respective positions, endorsing an exemption for bank services from class action legislation, are applicable to the proposals which are the subject of this hearing.

Earlier, we stated our objection to extending the jurisdiction of the FTC to banks and we feel we would be remiss if we did not document our objection.

Our most obvious ground for opposing the expansion of the FTC jurisdiction is that there is no need to impose another regulatory agency on the banking industry, in addition to the Board of Governors of the Federal Reserve System, the Comptroller of the Currency and the Federal Deposit Insurance Corporation and the Banking Supervisors of the States.

Our second objection to any language which may expand the jurisdiction of the FTC is based on our view of past action of the Commission. We believe the Commission has, at times, promulgated trade regulation rules which have been contrary to the demonstrated intent of Congress in enacting and amending the Federal Trade Commission Act and other Federal statutes. We also believe the Commission has ignored judicial decisions interpreting the Federal Trade Commission Act by promulgating those rules.

Section 5(a)(6) of the Federal Trade Commission Act specifically excludes banks and other regulated industries from the jurisdiction of the FTC. It is our understanding that the Supreme Court addressed itself to the question of the limits of the jurisdiction of the FTC by stating "The FTC, under Section V of the Federal Trade Commission Act has not jurisdiction over banks." *U.S. v. Philadelphia National Bank*, 374 U.S. 321, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963).

However, on May 14, 1969, the Commission announced the initiation of a rulemaking proceeding in regard to unsolicited mailing of credit cards. At that time, the proposed rule was not applicable to banks, common carriers and air carriers. The Commission held hearings on the rule and on March 18, 1970, promulgated a trade regulation rule prohibiting the mailing of unsolicited credit cards. At that time, the Federal Trade Commission attempted to exercise jurisdiction over bank services.

In any accompanying statement of basis and purpose of the rule, the Commission stated:

... However, the activity of issuing credit cards by banks appears to fall within the jurisdiction of the Commission under Section 5(a) (6) of the Federal Trade Commission Act when it occurs in interstate commerce and when (a) the credit cards are issued by a subsidiary or credit card company acting for a bank, or (b) the credit cards are issued directly by a bank to be used for services or products which are unrelated to the character of the bank's uniquely regulated business.

In view of the fact that banks are issuing unsolicited credit cards in direct competition with other businesses and credit card companies, it would clearly defeat the policy and provisions of the Federal Trade Commission Act to hold that the exemption accorded to banks under that statute must be construed to embrace even those activities which lie outside the sphere of a bank's essential function and are not incidental to those functions.

The Commission's statement was viewed by this association as most curious since the "principal banking products" were defined in the Philadelphia National Bank case to be:

... various types of credit, for example: Unsecured personal and business loans, mortgage loans secured by securities or accounts receivable, automobile installment and consumer goods, installment loans, tuition financing, bank credit cards, revolving credit funds...

U.S. v. Philadelphia National Bank, 374 U.S. 321, 326, 83 S. Ct. 1715, 1721.

The issue raised by the unsolicited credit card rule regarding the FTC jurisdiction over bank services is moot at this point in time since the Commission has rescinded the trade regulation applicable to unsolicited mailing of credit cards. The Commission rescinded the rule only after the Congress prohibited the mailing of unsolicited credit cards in Public Law 91-508 by specifically amending the Truth in Lending Act.

The Consumer Bankers Association believes, however, that the FTC acted outside of its legislative mandate and may do so again without notice. This association believes that any indication of an expansion of the jurisdiction of the FTC, no matter how inadvertent, will be seized by the Commission as an opportunity to impose another unneeded supervisory agency over the commercial banking industry. We oppose such an unnecessary result.

Mr. Chairman, we have several suggested amendments, which I will not read but would like to submit for the record: There are other methods that could be employed to achieve the desired results, and we are not implying that these suggested amendments preclude consideration of any other appropriate language.

One additional point that concerns the Consumer Bankers Association is the inclusion of civil penalties in S. 1222. We feel they are unnecessary in any event and, as drafted, excessively severe.

I thank you for this opportunity to appear before you and to present the views of the Consumers Bankers Association, and if you have any questions, I will attempt to provide answers for them.

Senator HARR. Thank you, particularly for suggesting the language that will be available to us.

The only question I would ask, I am thinking now of the commercial bank and its wide range of activities, and even though your activities are broad, could you suggest which of those activi-

ties could be alleged to, or some aspect of which one of those activities could be alleged to, go afoul of one of these proposed unfair methods.

Mr. OWENS. I guess there could be a number of them. For example, it could be construed that varying and different interest rates on different types of loans could be an unfair trade practice.

Senator HART. Let's just assume that there is an argument that that might be within the catchall category that Mr. Lamb suggested, is there anything in the explicit list of practices which might involve a claim that a commercial bank was——

Mr. OWENS. What we are really concerned about——

Senator HART. Acting improperly?

Mr. OWENS (continuing). That some customer will pick up and feel that he had an opportunity for action which could lead to very adverse publicity and threaten the solvency of the bank. I really feel, I would like to defer to the banking authorities since they feel fairly strongly on this, and I think they would express themselves pretty much as I have about this.

Senator HART. I think the committee should make an inquiry of several federal agencies that do have jurisdiction over banking.

Mr. OWENS. I have a couple of letters attached to my testimony from Mr. Burns and Mr. Camp.

Senator HART. At least this member of the committee will read it and I will see if I can get the other members to read it.

Thank you very much.

(The statement and letters follow:)

STATEMENT OF W. C. OWENS, ON BEHALF OF THE CONSUMER BANKERS
ASSOCIATION

Mr. Chairman and members of the Subcommittee, my name is W. C. Owens. I am Senior Vice President of the North Carolina National Bank, as well as First Vice President of The Consumer Bankers Association and Chairman of its Legislative Committee.

The Consumer Bankers Association is a trade association comprised of over 230 commercial banks located in twenty-nine states, the District of Columbia and Puerto Rico, which engage in providing instalment loans to consumers. We estimate that our members administer more than 40% of all consumer credit outstanding at all commercial banks. The Association places emphasis on new fields of instalment lending, new methods of operation and new approaches to management problems in the belief the instalment lending function of a bank is the vehicle by which the bank more fully serves the needs of the community. The individual bankers who give life and identity to our association are specialists in consumer lending. Our primary objective is to improve the consumer lending function of commercial banking so that all responsible individuals seeking consumer credit will have the opportunity to benefit from the services offered by the commercial banking industry. Such services include, but are not limited to, home mortgage loans, student loans, bank credit cards, automobile financing and other traditional extension of instalment credit which have proven so useful to many millions of American consumers.

We are pleased to be afforded the opportunity to present our views on the class action legislation pending before the Subcommittee. (S. 984, S. 1222 and S. 1378). The Association strongly believes that the pervasive and specialized regulatory system governing all aspects of the operations of the commercial banking industry makes it necessary and desirable that any consumer class action legislation enacted by Congress contain an exclusion for banks and other financial institutions. We also believe that such legislation should make certain that the jurisdiction of the Federal Trade Commission

is not inadvertently expanded in such a manner to cover banks and other comprehensively regulated industries which Congress, in its wisdom, has consistently excluded from Federal Trade Commission jurisdiction since the creation of the Commission in 1914. Finally, the Association urges that any consumer class action legislation enacted by Congress should provide for the maintenance of such suits only upon the successful conclusion of an action by the Federal Trade Commission or the Department of Justice.

All three bills before the Subcommittee, S. 984, S. 1222 and S. 1378, would, if enacted in present form, authorize classes or groups of consumers to institute legal proceedings against persons who commit an "unfair consumer practice," but since the bills are not identical, we would like to comment briefly on some provision of each.

S. 984 defines "unfair consumer practice" to mean any one of sixteen specified acts or practices. Included in that list in section 101(1)(p) is a broad catch-all which reads: "any other act or practice which is unfair or deceptive to a consumer and is prohibited by section 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1))." It is our opinion that this section of S. 984 may allow the Federal Trade Commission to obtain jurisdiction over banks since the Commission would be given the authority to declare "any other act or practice which is unfair or deceptive to a consumer" an unfair trade practice under section 5(a)(1) of the Federal Trade Commission Act. We believe that such a determination by the Commission would, in turn, be declared an "unfair consumer practice" under this proposed Act which could serve as the foundation for class action litigation by consumers.

Section 101(6) of S. 984 defines "services" to include "insurance services and similar provisions of intangibles, but not the providing of credit to the extent that credit is regulated under the Truth in Lending Act (15 U.S.C. 1601, et seq.), or the adequacy of services of common carriers to the extent regulated; . . ." We believe that the definition of "services" in section 101(6) poses particular problems since, in our view, "credit" is not regulated under the Truth in Lending Act. The purpose of that Act is to assure a meaningful *disclosure* of credit terms to enable a consumer to compare various credit terms available to him and avoid the uninformed use of credit. For reasons detailed later in this statement, we believe the term "services" should be redefined in all three bills pending before the Subcommittee.

The Administration proposal, S. 1222, the Consumer Fraud Prevention Act of 1971, follows the basic design of S. 984 by defining "unfair consumer practice" to mean any one of fourteen specified acts or practices committed by a "supplier." The term "supplier" is defined as "any person in the business of making goods or services available to consumers, either directly or indirectly." S. 1222 does not contain the broad catch-all which appears in S. 984, but in section 2(f) of S. 1222 "services" are defined as "the provision of intangibles, other than (i) insurance services (ii) credit services and services by common carriers and public utilities, to the extent that unfair consumer practices are prohibited with respect to these services under other Federal law or regulation;".

We believe the language of S. 1222 avoids, to a certain extent, the problems we see in S. 984 extending the jurisdiction of the Federal Trade Commission to banks because section 3(b) of S. 1222 proposes to make the fourteen "unfair consumer practices" specified therein "unfair or deceptive practices under section 5 of the Federal Trade Commission Act," from which section banks are exempt. However, to avoid the capriciousness which the Federal Trade Commission has shown in the past and which we will detail later, we believe that an appropriate amendment to S. 1222 is still needed to insure that the Federal Trade Commission will not, at some future date, assume the function of legislator, prosecutor and judge of the practices of the banking industry. We also are of the opinion that the definition of "services" in S. 1222 needs to be amended to make certain that services of insured financial institutions are not intended to be the subject of class action suits.

S. 1378 defines "unfair consumer practice" to mean any of five specified acts. Included is "any material statement, whether oral or written . . . in connection with the sale, lease, rental or loan or the offering for sale, lease, rental or loan of goods or services to consumers, or the extension of credit to consumers, (emphasis supplied) or the collection of debts from consum-

ers, which has the capacity, tendency or effect of misleading or deceiving consumers."

Again, we believe class action legislation should exclude the services provided by the commercial banking industry and other regulated financial institutions. We also believe the attempt to expand the jurisdiction of the Federal Trade Commission by including the broad catch-all language of section 3(a)(5) of S. 1378 is unwarranted and inconsistent with the Congressional intent expressed in the Federal Trade Commission Act.

BASIS FOR BANKING EXEMPTION

Banks are already subject to pervasive regulation by the states and the Federal Government. A bank, unlike most other suppliers of consumer goods or services, can obtain and retain its charter to engage in business only upon a finding that its operations are in the public interest. Every bank is subject to continuous and exhaustive supervision and examination by at least one, and often several, state or federal bank regulatory authorities. These authorities are given broad power under state law, the National Bank Act, the Federal Reserve Act, the Federal Deposit Insurance Act, and the Financial Institutions Supervisory Act to investigate any and all aspects of a bank's activities, through surprise examinations of each bank, and through the practice of requiring various reports of each bank's operations. The various bank regulatory authorities also have sweeping power to correct abuses. They can issue cease and desist orders, remove bank officers and directors from their jobs, cancel a bank's deposit insurance, withdraw the privilege of Federal Reserve System membership, and even close and liquidate a bank where they find such actions necessary.

The basis and justification for this pervasive regulation is the special public and governmental interest in maintaining the stability and soundness of banks and in limiting the nature and extent of the risks to which banks and bank customers are exposed. While there is no special public policy interest requiring protection of consumer goods producers against insolvency, the solvency and liquidity of banking institutions has long been regarded as vital to the functioning of the national economy in general and to the protection of bank depositors in particular.

In short, there are special public policy reasons to limit the risks to which banks are exposed. Banks are extraordinarily vulnerable to unmeritorious litigation. Banks are widely and popularly assumed to have the resources to pay substantial settlements and, because of their peculiar dependence upon the confidence of their customers, can generally ill afford the adverse publicity often generated by litigation. Moreover, the Federal Government has a unique and vital interest in preventing any needless exposure of banks to unmeritorious yet potentially costly litigation. The great majority of bank depositors' accounts are insured by the Federal Deposit Insurance Corporation and the risk of bank insolvencies thus falls heavily on the government itself. At the very least, legislation that may have the effect of encouraging or facilitating unmeritorious litigation against banks should be enacted only upon a clear showing of need.

No such showing has been made. In fact, in light of the extension state and federal regulation of banks, a class action remedy such as that proposed in the legislation before the Subcommittee is simply unnecessary in the banking field. The state and federal regulatory system under which banks operate already provides an infinitely simpler, less expensive and more effective remedy for consumer grievances than the cumbersome class action device. Bank customers who have been treated unfairly by a bank can seek redress through at least one—and usually several—bank regulatory agencies. These agencies are in a position to act promptly and efficiently on the basis of consumer grievances reported informally, often by telephone or letter. When a grievance is found to have merit, the bank is required by the regulatory agency to take immediate and full corrective action. No similar grievance remedy is available to customers of most other suppliers of consumer goods or services. The remedy available to bank customers—free, complete, and vastly more efficient than litigation—stands in striking contrast to the necessarily crude and unwieldy remedy of a consumer class action suit.

The limited exemptions contained in S. 984—the exclusion for "the providing of credit to the extent that credit is regulated under the Truth in

Lending Act"—and in S. 1222—the exclusion of "credit services . . . to the extent that unfair consumer practices are prohibited with respect to these services under other Federal law or regulation;"—are inappropriately narrow in light of the far more comprehensive regulation to which banks are subject. As noted above, the credit and lending activities of banks are subject not only to the disclosure provision of the Truth in Lending Act, but also to long-standing state and federal regulatory statutes, as well as the rules and regulations promulgated thereunder. The class action bills' exemption for banks should parallel and be coextensive with existing bank regulation. We suggest the reasoning that led to the limited exemption that would be granted to banks under S. 984 and S. 1222, quoted above, actually justified a considerably broader exemption for the services provided by banks and we believe our views are shared by the bank regulatory agencies.

In correspondence to the Chairman of the Committee on Commerce on September 30 and October 6, 1970, Mr. Arthur F. Burns, Chairman of the Board of Governors of the Federal Reserve System, and Mr. William B. Camp, Comptroller of the Currency, respectively, stated their position on the class action legislation pending in the 91st Congress, S. 3201, the Consumer Protection Act of 1970. For the convenience of the Subcommittee, we have appended copies of that correspondence to this statement and request that it be included in the record. The Consumer Bankers Association acknowledges that the comments of the Board of Governors and the Comptroller are directed at legislation not being considered at this time, but we believe their respective positions, endorsing an exemption for bank services from class action legislation, are applicable to the proposals which are the subject of this hearing.

OBJECTION TO EXPANSION OF FEDERAL TRADE COMMISSION JURISDICTION

Earlier, we stated our objection to extending the jurisdiction of the Federal Trade Commission to banks and we feel we would be remiss if we did not document our objection.

Our most obvious ground for opposing the expansion of the Federal Trade Commission jurisdiction is that there is no need to impose another regulatory agency on the banking industry, in addition to the Board of Governors of the Federal Reserve System, the Comptroller of the Currency and the Federal Deposit Insurance Corporation and the Banking Supervisors of the States.

Our second objection to any language which may expand the jurisdiction of the Federal Trade Commission is based on our view of past action of the Commission. We believe the Commission has, at times, promulgated Trade Regulation Rules which have been contrary to the demonstrated intent of Congress in enacting and amending the Federal Trade Commission Act and other Federal statutes. We also believe the Commission has ignored judicial decision interpreting the Federal Trade Commission Act by promulgating those rules.

Section 5(a) (6) of the Federal Trade Commission Act specifically excludes banks and other regulated industries from the jurisdiction of the Federal Trade Commission. It is our understanding that the Supreme Court addressed itself to the question of the limits of the jurisdiction of the Federal Trade Commission by stating "The Federal Trade Commission, under Section V of the Federal Trade Commission Act has no jurisdiction over banks." *U.S. vs. Philadelphia National Bank*, 374 U.S. 321, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963). However, on May 14, 1969, the Commission announced the initiation of a rule-making proceeding in regard to unsolicited mailing of credit cards. At that time, the proposed rule was not applicable to banks, common carriers and air carriers. The Commission held hearings on the rule and on March 18, 1970 promulgated a Trade Regulation rule prohibiting the mailing of unsolicited credit cards. At that time, the Federal Trade Commission attempted to exercise jurisdiction over bank services.

In an accompanying statement of basis and purpose of the Rule, the Commission stated: "... However, the activity of issuing credit cards by banks appears to fall within the jurisdiction of the Commission under Section 5(a) (6) of the Federal Trade Commission Act when it occurs in interstate commerce and when (a) the credit cards are issued by a subsidiary or credit

card company acting for a bank, or (b) the credit cards are issued directly by a bank to be used for services or products which are unrelated to the character of the bank's uniquely regulated business. In view of the fact that banks are issuing unsolicited credit cards in direct competition with other businesses and credit card companies, it would clearly defeat the policy and provisions of the Federal Trade Commission Act to hold that the exemption accorded to banks under that statute must be construed to embrace even those activities which lie outside the sphere of a bank's essential functions and are not incidental to those functions."

The Commission's statement was viewed by this Association as most curious since the "principal banking products" were defined in the Philadelphia National Bank case to be "... various types of credit, for example: unsecured personal and business loans, mortgage loans, loans secured by securities or accounts receivable, automobile instalment and consumer goods, instalment loans, tuition financing, *bank credit cards*, (emphasis supplied) revolving credit funds . . ." U.S. vs. Philadelphia National Bank 374 U.S. 321, 326, 83 S. Ct. 1715, 1721.

The issue raised by the unsolicited credit card rule regarding the Federal Trade Commission jurisdiction over bank services is moot at this point in time since the Commission has rescinded the Trade Regulation applicable to unsolicited mailing of credit cards. The Commission rescinded the rule only after the Congress prohibited the mailing of unsolicited credit cards in Public Law 91-508 by specifically amending the Truth in Lending Act.

The Consumer Bankers Association believes, however, that the Federal Trade Commission acted outside of its legislative mandate and may do so again without notice. This Association believes that any indication of an expansion of the jurisdiction of the Federal Trade Commission, no matter how inadvertent, will be seized by the Commission as an opportunity to impose another unneeded supervisory agency over the commercial banking industry. We oppose such an unnecessary result.

SUGGESTED AMENDMENTS

There are a number of ways that an appropriate exemption for banks and other financial institutions could be incorporated in any legislation which may be endorsed by this Subcommittee. One method, particularly adaptable to S. 984 and S. 1222, would be to redefine "services."

Section 101(6) of S. 984 should be amended to read as follows:

"(6) 'services' includes insurance services and similar provision of intangibles, but does not include services provided by any financial institution insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, or the Administrator of the National Credit Union Administration."

To achieve a similar result, section 2(f) of S. 1222 should be amended to read as follows:

"(f) 'services' includes the provision of intangibles, other than—

- (i) insurance services,
- (ii) services provided by any financial institution insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, or the Administrator of the National Credit Union Administration, or
- (iii) services by common carrier and public utilities, to the extent that unfair consumer practices are prohibited with respect to these services under other Federal law or regulations; and . . ."

In regard to S. 1378, we believe section 3(e) defining "services" should contain a similar exclusion proposed to S. 984 and S. 1222. We further believe that Section 3(a)(1) describing the type of statements which would constitute an "unfair consumer practice" should be amended to delete "or the extension of credit to consumers" since the Truth in Lending Act adequately regulates the disclosure of credit terms and conditions by lenders.

There are, of course, other methods that could be employed to achieve the desired results and we would not want to imply that these suggested amendments preclude consideration of any other appropriate language.

One additional point that concerns The Consumer Bankers Association is the inclusion of civil penalties in S. 1222. We feel they are unnecessary in any event and, as drafted, excessively severe.

Thank you very much for the opportunity to appear before the Subcommittee and present the views of The Consumer Bankers Association. If the members have any questions, I will be happy to try to provide the answers at this time.

DEPARTMENT OF THE TREASURY,
OCTOBER 6, 1970.

HON. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate,
Washington, D.C. 20510

DEAR MR. CHAIRMAN: This is in reply to your letter dated August 20, 1970, concerning the Consumer Protection Act, S. 3201. You ask our view as to whether the interest of the public would be served by an amendment to the bill excluding bank services from its coverage.

It is our conclusion, based on many years of experience of continuous examination of the ways national banks conduct their business, that the type of practices at which the Act is aimed, are not engaged in any material degree by such banks in their dealing with the public. The combination of restriction on entry into the banking business and the unusually close regulation and examination to which their daily operations are subject, are such as to effectively discourage the types of fraud and misrepresentation dealt with by S. 3201.

Although one could logically argue that a lack of demonstrated abuses is no reason for exclusion from coverage, we feel that there are compelling reasons for the contrary conclusion. Banking operations, because of restrictive branching laws, are generally more localized than other businesses. For this reason and also because of their increased financial ability to pay significant settlements, banks are more vulnerable to "strike" litigation than other businesses. The special dependence of a bank upon the confidence of its customers would obviously create great pressure to settle such litigation to the unfair disadvantage of the bank.

Under the circumstances, it is our conclusion that the public interest would best be served by the exclusion of banks from the coverage of S. 3201.

Sincerely,

WILLIAM B. CAMP,
Comptroller of the Currency.

CHAIRMAN OF THE BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C. 20551, September 30, 1970.

HON. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate,
Washington, D.C., 20510

DEAR MR. CHAIRMAN: I am writing in response to your letter of August 20, 1970, in which you ask for our judgment whether the interests of consumers and the public would be served under an amendment of S. 3201 proposed by the Consumer Bankers Association to exempt services provided by banks, savings and loan associations, and credit unions.

We have given careful consideration to the proposed legislation, your Committee's report, and the statement of the Consumer Bankers Association. It is our judgment that the kinds of fraudulent practices that S. 3201 seeks to correct (as indicated in the bill and the committee report) are not prevalent among financial institutions regulated and supervised by Federal agencies. Weighing, on the one hand, the need to protect consumers against such practices and, on the other hand, the need to maintain the financial soundness of banks in order to protect depositors and the public generally, we doubt that it would be in the public interest to subject these financial institutions to class actions as provided in this bill. The need to maintain public confidence in financial institutions makes them vulnerable to suits brought in hope of a settlement out of court.

We suggest that the exemption be worded to exclude "any financial institutions insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, or the Administrator of the National Credit Union Administration."

The additional wording proposed above would modify the amendment proposed by the Consumer Bankers Association by limiting the exemption to banks, savings and loan associations, and credit unions which are under Federal supervision.

Sincerely yours,

ARTHUR F. BURNS.

STATEMENT OF J. EDWARD DAY, SPECIAL COUNSEL, CONSUMER ELECTRONICS GROUP OF THE ELECTRONIC INDUSTRIES ASSOCIATION

MR. DAY. Mr. Chairman and members of the subcommittee, my name is J. Edward Day. I am special counsel for the Consumer Electronics Group of the Electronic Industries Association and I appear here representing the great majority of manufacturers of consumer electronic products consisting of television, radios, phonographs and tape equipment.

On the first several pages of my statement, Senator, I describe our organization, our efforts to work on the consumer problems which have been continuous and active. We have a consumer affairs council made up of executives of leading manufacturers. We have a full-time consumer affairs coordinator to work with this council. We have only a handful of customer complaints per month that are actually received by our group, and we send these for prompt handling by the organization most directly involved.

I will skip through my statement, and I request that the entire statement would, if it may, be printed in the record.

Senator HART. Your statement will be printed after your oral summation.

MR. DAY. I cover the problem you have heard about from a number of witnesses, Senator. I do not want from the repetition of it for it to sound like we are playing a broken record, but this is the point that we feel that this legislation would hit the wrong target, because we feel that the companies that are more likely to be engaged in bilking practices and in fraudulent practices are the type of companies that were described by a witness here on Monday and are not the established companies which are valuing their reputation and which have to give decent treatment to the consumer in order to stay in the competitive race.

One of the companies that was described by the witness on Monday, who was telling about the California situation, was a company in a line of business that for some reason or other I have noticed over the years seems to attract shysters, and he said in the course of describing one of his class action suits that the company went bankrupt in the course of the proceedings. So I do not see what was accomplished by the class action suit.

I think that these class action cases almost inevitably, if they involve a large number of members of the class and a substantial amount of money, are going to go on for a long period of time, and these here-today-and-gone-tomorrow companies are not going to be there at the end of all that to pay anything in many cases in my opinion.

We do feel, and we do not view this as a matter of scare tactics or idle slogans, we do feel that the danger of this legislation is

that many large, reputable companies will be wide open for large class action suits whether or not they are guilty of any wrongdoing. Also, we feel that in many cases the alleged wrongdoing will be only of a minor or technical nature.

I feel that because of the very large amounts of some of these class action suits, and the fact that it does often take such a long period of time to process them, that they do not end up actually putting some money or some restitution into the hands of the consumer on a prompt basis, which is what he wants, but they really involve a large penalty. They are a penalty method. On some of these things that are listed in the bill, as grounds for a class action suit, I feel the potential penalty is almost like giving a person a prison sentence for double parking.

The provisions of the bill, of course, have been worked on carefully, and attempts have been made to put in protections, and they are protections that are intended to eliminate frivolous suits that are brought with the wrong motivation. There is, for example, in section 102(d) of S. 984 the provision that:

If the court determines that the action has been brought frivolously with knowledge that the claim lacks probable cause and with intent to harass and intimidate the defendant, the court may in its discretion award the defendant the cost of the suit, including a reasonable attorney's fee.

I have two comments about that. First, I doubt if it would be possible in most cases to actually meet the burden of proof to show that the suit was brought with an intent to harass and intimidate. It might instead very likely have been brought as an exploratory operation or it might have been brought on the basis of a certain number of situations that might not be applicable to the whole class, but I think that would be an almost impossible burden of proof to meet.

In addition, the way I read the statute, that determination would be made at the termination of the case—I mean the way I read S. 984, that determination would be made at the termination of the case which could have gone on for a long period of time.

Another thing about that, many of these cases I believe would be brought under such sponsorship that there would not be anybody to pay these expenses and attorneys' fees at the end of the case anyway, because there are cases where people use a secretary in the office or somebody as the nominal plaintiff and the large amounts of expense that could be involved in defending one of these cases over a period of years could run up very high, and I doubt if that money would actually be forthcoming to pay the cost of the suit and the reasonable attorney's fee.

This relates to the fact that other witnesses have covered here, and I think it is a very genuine point, and that is there is a strong incentive for defendants who become involved in one of these tremendous cases, to try and wind it up some way or other and get rid of it, even if they feel they have not done anything wrong or even if they feel that if they go the whole course they will have an adequate defense. That is because of the fact that there is such a very large expense and preoccupation in handling a major case of this kind, and there is an effort, as we all know, in litigation involving individuals and various kinds of plaintiffs to try to wind

them up and not have them go on for years even if one has confidence in his case.

There is another aspect that has been touched on here in connection with that that we feel is very important, and that is the publicity damage of a huge lawsuit being filed which involves such a large figure that it gets into the daily press with extensive publicity and sensational attention. We seldom see anything in the papers, as we know, saying that at some subsequent date the attempted suit has been dismissed as not meeting the requirements of the Federal rules or orderly court procedure, but a large amount of the damage is already done by the publicity of the charges, which may be totally unjustified, against a company in a highly competitive line of business.

This business that we represent is intensely competitive, not only among the American manufacturers but with extremely effective foreign competition. A headline saying "\$1 Billion Consumer Suit Filed Against the Kokomo Television Company"—maybe I should have said Kalamazoo—will be seriously damaging to Kokomo in competition, even though the suit was frivolous and eventually dismissed as not meeting rule 23 requirements.

Now we notice in trying to follow this testimony and the discussion of this bill, which has been very thorough, there seems to be an underlying assumption that all of these cases are going to be terminated by the defendant paying something. One of the leading witnesses on behalf of these bills before the judiciary committee last year said 99 percent of these class action cases are settled. I think that is an unfortunate underlying assumption to have in any type of thing. Even somebody who has done something genuinely criminal, and not merely a borderline violation of a deceptive practices rule, even the worst people in our society are entitled to be considered innocent until proven otherwise. But all of the discussion of this legislation seems to be pointed toward the defendant paying. The reason I say that is that there is no way to finance one of these cases in the normal situation unless the defendant does pay.

If the class is large, involves notice to a large number of people, involves communications with them, it is going to have to be paid for by somebody, and the courts do not have a pot of money to pay for notices and mailing to perhaps hundreds of thousands of people.

Everything I see in discussion of these bills is on the assumption that, whether it is 1 year or 5 years or 10 years later, the defendant is going to end up paying for all this expense as part of either a judgment against him or as part of a settlement. I do not think we should assume that the defendant is always going to have to pay. He may much too often, as a practical matter, have to settle just to dispose of the matter, but there could be enormous expenses involved in the course of a very conscientious effort to liquidate the case through a settlement, because as you know the bill provides there must be notice to members of the class about the proposed settlement, and there again somebody has to pay for that, and I do not see anybody available to pay it except the defendant.

We do not want to be here in the position of seeming to be "anti" or obstructionist or anything of that kind. You asked a very pertinent question earlier about these State class action laws. I would oppose such a consumer class action approach at the State level, too, because of the fact that your class action tradition has been built up on situations where all of the members of the class are in the same situation or approximately the same situation, in a stockholders' suit or in an antitrust suit.

In the case of a class of consumers they may be in a wide variety of situations. Just as an example, nearly all of the companies in our type of business give warranties, some of them quite extensive, some of them quite long. Some of these consumers may have had a disappointment with the product or a violation of these statutory principles while their warranties are still in effect. Others may be long out of warranty. Some of them may have had some repair work done in the process and some of them may not. Some of them may have given the necessary care and required maintenance to the piece of equipment and some of them may not, because in the case of a television set, in contrast to some other types of equipment, there does have to be periodic servicing. A color television set particularly is an extremely complicated matter.

Now what happens in the case of one of these products that is still in warranty? Does the defendant admit something by making the repair during a warranty period? Does he make an admission against interest? Does he hurt himself in the exposure that he has in the lawsuit? Should he hold back on making the necessary adjustment, or should he go ahead and take the chance that this may be used against him in the lawsuit?

In the bill that is not the principal bill here, but in S. 1378 we, of course, are very concerned about the provisions which bring State law into the picture. It is not just for use of rule 23 in that particular State but for the purpose, as this bill would say, of bringing in liability under State statutory or decisional law for the benefit of consumers, just absorbing that right into this list of things that can be ground for Federal class action suits and, as we read it, permitting a consumer in California to be included in a class where the class has filed a suit in Maryland under Maryland law against a manufacturer from New York.

We think the uncertainties of that, in view of the fact that some of the State laws may be considerably different or even directly contradictory, we think the dangers of that are almost insuperable. We are greatly concerned about that aspect.

We do point out, as others have here, that we do not think this really gives the consumer the type of restitution on a prompt basis that he deserves to have in a proper case where there actually has been the significant violation of these principles. The cases will go on too long in the course of administering these immensely large and complicated class action matters, and we think it would be a long time before the consumer recovers, and we do not think that is the type of a remedy that will really help in the long run.

Thank you, sir.

Senator HART. Thank you, Mr. Day.

Just one point, although you raise many and serious objections.

You may have heard me suggest that the principal, or a chief complaint, fair or unfair, from the consumer, is described by the expression "it don't work."

Now, if there was a class action alleging a malfunctioning, or whatever you would call it, of a product, in that action there would or would not be the need for different subcategories of hearings to determine whether Mr. A in the class had more or less damage than Mr. B in the class.

At least I would assume there would not be this problem of refining within the class. Would you agree with that?

Mr. DAY. I think it depends, Senator, on what would be the cause of that failure to work.

If there is a definite defect that was in there when the equipment was put on the market, and it is the same defect for everybody, I can't conceive of the type of company that are represented by our group or by Mr. Lamb's group or these others, being able to survive if they allowed judgment to come that said that they had put out a piece of equipment that had a general and uniformly defective aspect to it so it would not work. They would not be able to be in business long enough to even be worrying about this kind of case.

What is more likely to happen is there could be a dispute about whether some failure of perfect performance, or satisfactory performance, after the piece of equipment had been in the hands of consumers for a period of time, was due to some defect in the equipment, or whether it was due to some damage caused by the consumer, or whether it is an isolated case of a few sets that got through the quality control and didn't have the proper steps taken to correct them.

I can't conceive of a situation where there is a defect that is applicable to everybody—that really keeps the piece of equipment from working—where the companies would even dispute their responsibility to correct that promptly.

Senator HART. One of the things we always assume, and you state it explicitly, is the members—and the level of responsibility in your association and in Mr. Lamb's and these others—simply would not allow something to go on the market that doesn't work. I would have to find for the automobile manufacturers that same sense of responsibility, they are not fly-by-nights, but my God, they do manage to get stuff on the market that doesn't work, and it isn't a casual one in a million that the inspector misses as the callbacks suggest; it is a sizeable number of units.

So, we ought not to make the absolute assumption if a manufacturer is trying and is responsible that that kind of product would not come on the market, because it does.

Mr. DAY. Of course, that does get into a matter of putting one type of industry or one group of industries against another. The statistics on the consumer electronic products are very good in regard to customer satisfaction, and there have been recent polls which show our products ranking very high on the basis of consumers' feeling that they get a satisfactory product.

I can't speak for every kind of product and maybe I am against the trend, but I drive a 6-year-old car and it has never had anything much done to it, and it works just fine.

Senator HART. I am glad to hear it. Is it an American make?

Mr. DAY. Yes, sir. It is a Ford, LTD.

Senator HART. Thank you very much.

And I apologize to you, as I do to the others, for having this schedule problem.

Mr. DAY. Thank you, Senator.

(The statement follows:)

STATEMENT OF J. EDWARD DAY, SPECIAL COUNSEL, CONSUMER ELECTRONICS GROUP,
ELECTRONIC INDUSTRIES ASSOCIATION, REPRESENTING CONSUMER ELECTRONICS
MANUFACTURERS

Mr. Chairman and Members of the Subcommittee, my name is J. Edward Day. I am special counsel for the Consumer Electronics Group of the Electronic Industries Association and I appear here representing the great majority of manufacturers of consumer electronic products consisting of television, radios, phonographs and tape equipment.

We appreciate the desire of the Subcommittee to grapple with the problem of increased protection for consumers. We feel that the record of our industry on concern for the consumer is good. Our goal is to produce a safe and well made product available at a price which will be attractive to the customer.

Our industry represents about \$5 billion of annual sales volume at the manufacturer's level, of which about \$2.5 billion is in television and \$2.5 billion in other products. This would represent about \$8 billion in annual sales volume at retail.

There are about 90 million television sets in use in the United States today, of which about 64 million are black and white and 26 million are color. Annual sales are about 13 million television receivers, divided approximately evenly between color and black and white. We estimate that there are 500 million units in total of the four products we represent in American homes.

There are 14 domestic manufacturers of television receivers and about 10 major importers who sell under their own label in this country. There are some very large and some very small companies in this group, and many more small companies who manufacture tape equipment, phonographs and audio components. The companies we represent are intensely aware of the importance of consumer satisfaction and fair treatment of the consumer.

We have in excess of 200,000 people employed in the manufacturing and related aspects of the four products represented by our Consumer Electronics Group. Our business is unusual in a most important respect affecting consumers. Our prices have been going down over the years instead of up. Retail prices of consumer electronic products, even in this era of almost constant inflationary pressure, have shown a dramatic decline since their first appearance in the Bureau of Labor Statistics Consumer Price Index. Using the 1957-59 standard of 100, television was 125.7 in 1951, but for 1970, the average for television receivers was 80.1. There has been a similar trend for phonographs, radios and tape recorders.

We are an intensely competitive business not only among the American manufacturers, but with foreign manufacturers who accounted for about 2.8 million units of television receivers sold in the United States under foreign labels in 1970.

Some of the companies use a one-step distribution system where they sell directly to retailers. Others use a two-step system utilizing distributors. There are approximately 20,000 full-line consumer electronic retailers who sell our products, and perhaps another 20,000, such as general merchandise stores, which sell some of our items.

In contrast to industries such as automobiles and gasoline, we have very little in the way of the captive dealer in our business. Most of our retailers are selling more than one manufacturer's product and the goods pass title when they go to the distributor or directly to the retailer.

In our Group, we have a Consumer Affairs Council made up of executives of many of the leading manufacturers. We have a full-time Consumer Affairs Coordinator to work with the Council.

We have only a handful of customer complaints per month received by our Group and we send these for prompt handling by the organization most directly involved.

Various ones of our members have embarked on their own programs of special emphasis on consumer satisfaction. For many of them this has taken the form of specialized consumer affairs departments with special responsibilities for consumer information, consumer safety and product satisfaction.

We are concerned about all of the class action proposals which are pending before this Subcommittee. We are fully sympathetic with the Committee's desire to eliminate unfair consumer practices and to help the consumer with a legitimate complaint to obtain redress. But we are convinced that the proposed class action legislation does not provide either an effective or a fair means for seeking that redress.

The great majority of businesses do not try to cheat or deceive the consumer. While agreeing with and commenting on this point during last year's hearings on class action legislation, the Chairman of this Subcommittee commented on what the scope of this type of legislation should be when he said:

"... the problem exists in really a very small segment of the industry—those who take advantage of the freedoms they now have in order to deceive and bilk the consumer... The vast majority of business is very anxious to settle complaints and take appropriate steps. Therefore, what we are directing our legal sanctions at, if we can keep them on target, is again this small segment that does not try to practice good business ethics and is causing loss in the marketplace."

We agree with the spirit of the Chairman's comment. But we sincerely believe that the legal sanctions provided for in the pending class action proposals will end up hitting the wrong targets. Remedial legislation should be directed toward fly-by-night operators and other undesirable marginal types of businesses. Instead, these class action provisions could well subject legitimate businesses, such as we represent, to unjustified expense and harassment by persons motivated by desire for personal gain rather than protection of consumers.

For example, what would a group of consumers or their attorney expect to gain by filing a class action suit against a here-today-and-gone-tomorrow, fly-by-night company; or against a company with limited assets or a shaky financial structure?

This is the type of situation where the consumer may be most in need of help. But in a large number of cases in this type of situation, the real culprit is someone who is here today, but will be gone by the time a cumbersome class action suit could inch along to a conclusion. Even if the claim is a very good one it may be impossible to obtain redress by a class action suit.

These unscrupulous operators are much more likely to be operating on a local level and we endorse the view that state law should provide the private remedies for defrauded consumers.

The real targets of this legislation, unintended though it may be, will be the substantial financially sound businesses that have been able to grow because of their legitimate business practices. Few, if any, would start a lawsuit against an obscure, dubious company when they could sue a large, well financed firm.

Our concern about this proposed legislation centers around the real fear that reputable companies will be wide open for large class action suits whether or not they are guilty of any wrongdoing. Even in cases where such a company might totally win, it could cost hundreds of thousands or even millions of dollars to defend the suit. This cost would obviously have to be passed on to the consumer.

In many cases where such a company knew it could prove eventually that it had committed no wrong, it would often, for practical considerations, have to reach the decision that its best course of action was to try to reach a settlement. Companies must do this today in suits by individuals. In a class action suit there would be increased pressure to pay something, no matter how frivolous the suit, to avoid the expense and preoccupation of a protracted court case. In such a situation the defendant company would have to absorb all the costs—both direct and indirect—incurred up to that point in the proceeding. Then, by virtue of Section 102(c) of S. 984 or Sec-

tion 13 of S. 1378, it would have to bear the entire cost of communicating the settlement offer, or subsequent offers, to the members of the class. If agreement were reached it would pay each such member. Finally, it would appear that Section 102(d) of S. 984 or Section 14 of S. 1378 could subject it to paying attorney's fees and costs. All of this when the company might be guilty only of being sufficiently big and financially sound.

We are well aware of the fact that there are provisions in some of the bills which undertake to discourage unjustified and harassing class action suits. For example, Section 102(d) of S. 984 provides that upon termination of a class action suit, if the court determines that the action has been brought frivolously, with knowledge that the claim lacks probable cause and with intent to harass and intimidate the defendant, the court may in its discretion award the defendant the cost of the suit, including a reasonable attorney's fee. This might sound on its face like a substantial protection. However, there are several aspects of this language which must be borne in mind. The determination referred to is not to be made until the termination of the class action suit. Because of the complexity of this type of proceeding, and the crowded conditions in the federal courts, such a suit might go on for many years. During this time the defendants are accumulating what is likely to be very large direct legal expense and also substantial indirect expense, such as those resulting from the preoccupation of executives and other personnel with long drawn out litigation. Cost increases must, of necessity, eventually be reflected in the price of the product. Therefore unnecessary additions to cost tend to hurt rather than help the consumer.

Second, it would be difficult if not impossible, in most situations, to prove that the class action suit was brought "with intent to harass or intimidate the defendant." The more likely motivations of persons unjustifiably initiating such suits are personal publicity or the desire to conduct a fishing expedition to see if some basis for recovery can be unearthed. Even if the difficult burden of proof on intent to harass or intimidate is met and a determination is made on each of the points required, it will, in the nature of things, be difficult for the defendant to realize anything from an award by the court to the defendant of the costs accumulated in defending the suit, including the attorney's fees. These cases will typically have been brought on a speculative contingent fee basis by persons who, in many cases, would not have substantial funds and could not, in fact, make good on paying the large cost of defending the suit.

Nevertheless, what little protection that is provided by Section 102(d) is not found in either S. 1222 or S. 1378.

We realize that the rules of the federal courts are directed toward trying to avoid some of the more frivolous or far-fetched attempts at class action suits. However, we can all see from the reading of our daily newspapers the extensive publicity and sensational attention which accompanies the filing of large class action proceedings. We seldom see anything in the newspapers as to whether the attempted suit has been dismissed at some subsequent date as not meeting the requirements of the federal rules or of orderly court procedure. But a large part of the damage is already done by the publicity of the charges—which may be totally unjustified—against a company in a highly competitive line of business. A headline saying "One Billion Dollar Consumer Suit Filed Against The Kokomo Television Company" would be seriously damaging to Kokomo in competition, even though the suit was frivolous or was eventually dismissed as not meeting Rule 23 requirements.

Section 102(c) of S. 984 provides that actions for redress of consumer injury should be administered to facilitate "voluntary settlements." This is a desirable objective. But class action legislation is an undesirable way to accomplish that objective. As I mentioned earlier, our companies have been working hard to satisfy consumer complaints. We believe our record is good. But there are numerous troublesome uncertainties about the actual working of the class action proposals in the real world of business that could cause the prudent businessman to temper his efforts toward greater consumer-mindedness.

For example, we do not know what would happen if a class action proceeding were started based upon an alleged failure to disclose some defect in a piece of equipment, and while such proceeding was pending, various persons who had purchased that piece of equipment asked for replacement of a part under the warranty provisions applicable to the equipment.

Would the manufacturer be able to satisfy the warranty requirement without running the risk of having the plaintiff's lawyer in the class action suit claim that he had admitted the plaintiff was right? Let us say, for example, that a class action suit was begun, relating to a phonograph, on the theory that the advertising or selling practices failed to disclose that under certain conditions the sound volume might be reduced. If this was due to some unexpected minor defect, would the manufacturer nonetheless be handicapped in giving satisfaction to individual customers by replacement of a part pursuant to the warranty just because this might be used against him in the class action case?

What about the converse of this situation? Suppose that no class action suit has been filed when a consumer submits a complaint to a manufacturer. Suppose further that the manufacturer concludes, and properly so, that he is not at fault and not required to pay the consumer. But, for the sake of good customer relations, he repairs or replaces the product. Does he now open himself up to a class action proceeding by others with differing situations trying to obtain the same relief?

Of all the provisions included in the three bills being considered today, probably the most impossible is Section 3(a)(4) of S. 1378. This section provides that one meaning of the term "unfair consumer practices" is "violations which give rise to civil liability under state statutory or decisional law for the benefit of consumers."

If this were to be enacted into law, no businessman would have any idea what his potential liabilities might be. The section could be construed as applying to the vast majority of state statutory and decisional laws. Even if it were not applied on such a broad scale, it would radically broaden the scope of the consumer class action concept. It would virtually assure every financially sound business of several large class action suits every year. As an individual, what better way to force a company to give in to your demands than by threatening a multi-million dollar lawsuit. Even if the company were totally in the right, it would be cheaper to pay off the one or a number of unscrupulous individuals than to defend the class action suit.

In addition to the difficult and time-consuming problem of determining whether or not the class meets the requirements of Rule 23, the court will also have to struggle with the question of whether or not the state statutory or decisional law under which the suit was brought was one for the "benefit of consumers." This will often be a very difficult question to resolve. No matter what the court decides on this question, it is almost a foregone conclusion that the losing party will appeal. A great deal of additional cost and time will be expended.

Another question raised by Section 3(a)(4) is, which State's law will apply? Can consumers living in California be included in a class of consumers who file a suit in a Maryland court, *under Maryland law*, against a manufacturer from New York? If so, is this fair? I think not, particularly since California might have a law which takes a position opposite that of the Maryland law.

There was some remarkable testimony on this type of legislation last year by one of the leading advocates at that time of a consumer class action bill. He first stated in support of class actions: "No government agency can possibly handle the number and variety of cases and transactions involved. The bureaucratic cost would be staggering." This indicated a huge volume of cases. Yet later in his testimony, he indicated that there would be no danger of overloading the courts with class action proceedings. We can't understand why an alleged volume of cases which would bog down federal regulatory agencies would contain no danger of bogging down the federal court system.

We believe that federal action on consumer protection should be directed against the unscrupulous and fraudulent operators and should not carry the potential for highly publicized defamation of responsible manufacturers and retailers. These bills each carry an alarming underlying assumption that the defendant company is always going to be wrong and is always going to have to pay up and to finance the enormous costs of the suit. It is not in the public interest to lend Congressional credence to an attitude which says that business in general is suspect and that consumers will only be treated fairly by American enterprise if a whole series of federal remedies and federal enforcement actions is provided.

The fly-by-night operators and the chronic chisellers will not fear these class action cases. They will not be around when the case has finally moved

to judgment. If they are still around, they are unlikely to have locatable funds which can be used to make payments to consumers.

We urge that responsible and reliable companies not be exposed to the field-day of anti-business litigation which this legislation is bound to bring about. By their nature, class action suits drag on for a long period of time. We are advised that since July 1, 1966 when the new federal court rule on class actions became effective, there has not been one contested case fully litigated as to both liability and damages. This means that recovery and restitution for individual consumers, even when liability is eventually proven, are going to be long delayed. When a consumer needs redress of a legitimate grievance or recovery of \$50 or \$100 in damages, he is not going to feel federal consumer advocates have done him a favor if their legislative solution makes him wait years for action. Who really gains in a huge class action suit over an alleged defective transistor radio?

We believe the consumer would be much better served by permitting him to seek his redress through local or state agencies. A strengthening of local small claims courts, for example, possibly by federal grants, would be of much greater benefit to a consumer attempting to collect \$20 or \$50 than would a class action lawsuit, over which he has no control, which might last five or ten years.

Where the problem is of sufficiently general impact so that federal assistance is genuinely needed, the Federal Trade Commission should be ready and able to take the appropriate action. Consumer protection should not be turned into a vigilante operation by encouraging mammoth lawsuits that could be motivated more by the self seeking and vindictiveness of a few, rather than by a desire to advance the public interest.

I appreciate the opportunity to appear before the Subcommittee.

Senator HART. It is my understanding that the testimony that was scheduled to be received from the National Small Business Association through Mr. Rothwell will be filed for the record.

It will be printed in full.

(The statement follows:)

STATEMENT OF THOMAS A. ROTHWELL, ON BEHALF OF NATIONAL SMALL BUSINESS ASSOCIATION

Mr. Chairman and Members of the Committee, my name is Thomas A. Rothwell. I am an attorney with offices in Washington, D.C. My appearance here today is on behalf of National Small Business Association representing some forty thousand business concerns, a substantial number of which are manufacturing firms, doing business in over five hundred different industry categories. I am accompanied by Mr. Herbert Liebenson, Legislative Vice President of the Association. We appreciate the Committee's giving us an opportunity to comment on the proposed Consumer Class Action Act of 1971.

It is evident that the business community of the nation has been subject for many years now to "a bad press" to say the least. From Mr. Nader and his colleagues on the one hand, to television and press on the other hand, have come criticisms, exposures, and unrestrained abuse accusing the business man of a wide range of social wrong doing, from being an incorrigible predator in dealing with consumers, to destroying the environment including the water, air, and the good earth itself.

Reports from the Youth Conference held in Colorado under the auspices of the White House and attended by an alleged cross section of the nation's youth discloses that while these young people were in favor of legalized marijuana and the immediate cessation of hostilities in Vietnam, they were most cool and aloof and out of sympathy with a presentation dealing with the workings of, and the benefits flowing from the free enterprise system.

Perhaps we should ask "What else could we expect?" Considering the one-sided and recurrent tidal wave of anti-business propaganda, information, suspicion, speculation and charges, and the almost total absence of any effective attempt from qualified and authoritative sources to present a balanced viewpoint, it is small wonder that the youth of the nation seem to be out of sympathy with the only economic system that we have.

It is also a truism that we must have an economic system. The choice of day seems to be between some sort of state-regulated economy, as exists on

the dark side of the Iron Curtain, or a system geared to and fueled by the ambition and the initiative of individuals. Each system has its own mix of advantages and disadvantages, however we know of no responsible element in our culture that asserts that the time has now come to change the basis of the system.

As a set of working assumptions, it is suggested that we accept the premise that the economic system of private capitalism is not finished, and that legislative and administrative efforts to control the excesses and the abuses in that system should, nonetheless, stop well short of dismantling that system.

The Class Action Bill is based on an assumption that large numbers of consumers are being cheated by the devices and tricks of a substantial segment of American business. Further, it is argued, that, inasmuch as the claims of the injured or defrauded consumer are minor on an individual basis, only by aggregating claims will an effective remedy be devised.

We take direct exception to the diagnosis on which this remedial proposal of class action is predicated. The original impetus to class action proposals was the 1968 Report of the Federal Trade Commission pertaining to commercial practices in the inner-city areas. The gist of that report was that the residents of the nation's ghettos were being subject to over-reaching, over-charging, fraudulent and inequitable practices by merchants serving this strata of consumers.

From this original seed the class action proposals have sprung, and have been presented against a background of both urgency and inevitability. It is our purpose to question both of these assumptions.

1. The enactment of class action legislation is neither urgent nor inevitable.

2. The remedy is manifestly inappropriate. It is much too vast and formidable a remedy in terms of magnitude, and in addition is really directed to the wrong target. Here the analogy to the use of thermo-nuclear weapons to prevail in Vietnam is most appropriate.

In its large social sense a class action remedy does nothing more or less than give legal sanction to a form of mob rule as to the economic life of the nation. Since class actions themselves proceed on the basis of litigation by oppression, it will be evident in retrospect that the class action remedy has been effective as the guillotine, the instrument that spells finish to uncounted numbers of businesses worthy and unworthy alike.

Class action gives to every lawyer admitted to practice in the United States the power to dismember and destroy thousands of business enterprises, all on a purely discretionary basis.

To turn such monumental and vital decisions as to the economic life of the nation over to the lawyers and judiciary of the nation is in a very special sense an abdication of constitutional responsibility on the part of Congress. It comes down to the proposition that if there are enough complainants willing to assert a claim, well-founded or otherwise, only the largest and the most formidably-financed businesses can afford to endure the risks inherent in class action litigation.

On yet another basis, the existence of a class action remedy will raise market entry barriers, as it will obviously serve to discourage new market entrants, for about the same reason that soldiers try to avoid a mine field.

The existence of the class action remedy will have a similar effect in stifling, suppressing, and indeed even punishing creative innovation, which in the past has been one of the most viable competitive resources of the small.

There is ample precedent for the structuring and application of an appropriately discreet remedy, which will have a maximum opportunity to be effective, and with minimal and incidental injurious fall-out.

Once more we invite Congress to consider the direct benefits of a system of neighborhood Consumer Courts, which would provide working justice at no cost to defrauded consumers. This proposal was made in prior hearings on this measure, to no avail. In spite of this, however, it is a fact that a system of Consumer Courts could meet the problem head on, as compared to the class action approach, at the social and economic cost of declaring an "open season" on the business community.

We also emphasize that restrictive labor practices in manufacturing and construction industries that raise consumer costs for which no economic service is given should also be subject to class actions.

Such practices as knocking down and then reconstructing factory-cut and assembled products, restrictions of uses of machine and hand tools that would

speed up production, the unnecessary packing and re-packing of shipments at the dock, and other restrictive practices unnecessarily increase consumer costs. In a recent statement Senator Fannin stated that restrictive practices in construction hit hardest in low and moderate income housing and in some cases can add \$2,000 to the price of a home.

If the New York subways or our nation's railroads were shut down by a strike, thousands of people would be unable to get to work. A tremendous amount of income would be lost by the consumers who commute by subway or railroad. Certainly the cost of transportation is as much of a consumer cost as the purchase of a product for the home.

Whether an individual is a victim of a pickpocket or an armed robber his loss is just as great. On the one hand he is not immediately aware of his loss while on the other he is upset emotionally and may wish to react physically. If proponents of class actions wish to provide a weapon for effective justice in the marketplace, they should also support class actions to be brought for *any* unfair practices that rob consumers of their hard-earned dollars and deny their receiving full value for their expenditures.

Thank you for this opportunity to present our views before your Subcommittee.

Senator HART. So, that leaves us for our final testimony with Mr. Edward Dunkelberger, general counsel of the National Canners Association.

STATEMENT OF EDWARD DUNKELBERGER, GENERAL COUNSEL, NATIONAL CANNERS ASSOCIATION

Mr. DUNKELBERGER. Thank you very much, Senator.

My name is Edward Dunkelberger; I am appearing as counsel for the National Canners Association, a nonprofit trade association of about 550 members from all parts of the country.

With your permission, I will read just excerpts from my statement, with the understanding that it will be put in the record.

Senator HART. It will be included.

Mr. DUNKELBERGER. I will skip about from time to time in the statement.

We appreciate this opportunity to appear before the Consumer Subcommittee to express our views on the consumer class action bills now under consideration by the committee.

Last year we noted in particular two dangers of the class action technique that we think merit your consideration, which have been elaborated on quite extensively the last 2 days.

The first serious difficulty is the potential, too often realized, that the threat of a class action lawsuit and the attendant publicity and expense may be employed as a vehicle for harassment and coercion. The second and related concern is that the provision for attorneys' fees provides an incentive for the filing of suit in situations where the merits of the case would not otherwise justify it.

At the same time we recognize the legitimate interest of the proponents of this legislation in establishing an effective means of both discouraging fraudulent practices that victimize consumers and of compensating consumers who have suffered losses from such practices. For many types of products there may be few if any existing Federal regulatory programs that can be expected to achieve the goal of preventing fraudulent practices, and consumer class actions are seen as an across-the-board approach that could prove to be an effective deterrent.

Equally important, the proponents maintain, is the need to prove a vehicle for compensating consumers who have suffered losses that are more than negligible but not sufficiently large to justify individual private action.

Society obviously has an interest in the existence of an effective means for the prevention of fraud and deceit and for compensating those found to be injured by such practices. But there is also a substantial public interest in discouraging frivolous, harassing or inconsequential litigation which unduly clogs our judicial system, constitutes an unnecessary social cost, and threatens the economic life of the potential defendants.

To place our testimony today in perspective, we firmly believe that the degree of regulation applicable to food products—and in particular to canned foods—already strikes a reasonable and effective balance between the competing needs of the public. As we have indicated, we are not aware that the fraud and deceit said to give rise to a need for new consumer protection legislation can be found in the canning industry.

Indeed, the intensive regulatory controls embodied in the Federal Food, Drug and Cosmetic Act provide a high degree of protection for consumers against fraud and deceit in the food labeling and composition. The great bulk of canned foods are governed by definition and standards of identity, minimum standards of quality, and standard for fill of container. All of the labeling and adulteration prohibitions are backed up by strict criminal liability.

It was thought by Congress to be so important that our food supply not be adulterated and not misbranded that a violation without a showing of intent can lead to criminal liability. This novel aspect of that act—involving a significant departure from the traditional requirement that intent be a necessary element of any crime—has been explicitly upheld by the Supreme Court. We are now operating under that kind of regulation.

In addition, you can have seizure of violative products, and sweeping injunctive authority. The Wheeler-Lea amendments to the Federal Trade Commission Act provided special protection to consumers against false advertising of foods, drug and cosmetics—including provision for preliminary injunctions and criminal penalties.

With this broad range of Federal controls against fraud and deception in the marketing of foods—most of which have their counterparts in State laws and regulations—we see no basis whatever for the canning industry being exposed to the potential harassment, expense, and publicity of class actions that cannot possibly provide consumer protection in as rational, comprehensive, and effective a manner as existing Federal and State regulatory controls.

Against this background, we believe that the requirement of S. 984 that, to become a member of the class in a class action suit, a consumer must have paid or become obligated to pay \$10 or more in the transaction resulting from the alleged deceptive act or practice is eminently reasonable. This is true not only because it will preserve the jurisdiction of the Federal courts against one spectrum of cases in which the individual loss involved is so small that its recovery cannot be said, in the balance of social interests and priorities, to

weigh heavily enough in the scale to justify the expenditure of judicial resources necessarily required, but also because it indirectly recognizes the existing intensive regulation that I have described.

Wholly aside from the point that subjecting our highly regulated industry to the terms of the bills before you would constitute a peculiarly wasteful and duplicative expenditure of social and judicial resources, we find that we must question whether as a matter of social policy application of this kind of attempted regulation is justified at all.

We do not have an easy answer for this question and can only represent that we are deeply troubled, and that we believe that this is the most fundamental question raised by the subject matter you are investigating, and that it should receive, and indeed has received, the intensive attention of the committee.

If, after its deliberations, this committee concludes that the class action does have a potential as a vehicle for consumer protection, at the least you should frame legislation in a manner that respects the unavoidable difficulties that will be presented and is designed to protect in some measure, the jurisdiction of the Federal courts from the frivolous and the harassing case. It is most often the early stages of class actions—the procedural elements of the case involving definition of a clause, providing adequate notice to its members, et cetera—that are most burdensome, time-consuming, and expensive. These come before the merits are reached.

One reasonable limiting device to insure that it is the significant cases for which the jurisdiction is exercised is employment of the so-called “trigger” provided for in S. 1222 and in section 192(a) of S. 984. Other methods will undoubtedly be advanced.

Our concern is to bring to the attention of this committee the need for careful deliberation of these limitations in finding the balance that must be struck between the society’s essential requirement of a sound allocation of judicial resources, which is of direct benefit to every individual member of the society, and its consumer production needs, if the committee concludes that a class action jurisdiction is to be created. In this balance, as Judge Murrah urged in testimony last year, there must be some kind of screening device.

In addition, a provision that commends itself to any ultimate bill that this committee might agree upon is that found in section 6(b) of S. 1378, which gives to the Federal court any action brought under the consumer class action jurisdiction the final discretion to determine, in all of the circumstances, whether it is appropriate and in the best interests of all concerned that the case be entertained.

This discretion would permit the court to establish criteria applicable to the particular variety of cases sought to be brought within the class action jurisdiction, without, in protecting their jurisdiction, having to do violence to the principles of rule 23 of the Federal Rules of Civil Procedure, and thereby potentially undermining the liberal construction of that rule that now applies for class actions brought within one of the traditional jurisdictions of the court.

Turning from the general to the particular, if this committee decides that a consumer class action jurisdiction is warranted, and that in defining the scope of that jurisdiction, the laundry list approach of S. 984 should be adopted, we believe that there are several re-

spects in which the language of S. 984 should be improved to avoid vagueness and ambiguity, and to give fair warning to those who will be subject to the bill's provisions of what they are proscribed from undertaking. Many of these problem areas we pointed out to the committee in our testimony last year.

If I may, I would like to point to the one of greatest concern to us, subsection 101(1)(P). This subsection is new, and the radical change it authorizes in the administration of section 5(a)(1) of the Federal Trade Commission Act cannot be viewed lightly.

By subsection (P), S. 984 declares an "unfair consumer practice," that may be made the basis of a class action in Federal court, "any . . . act or practice which is unfair or deceptive to a consumer and is prohibited by section 5(a)(1) of the FTC Act . . ." There is no requirement of a prior FTC determination that the act or practice is violative of section 5(a) of the FTC Act, and where the individual consumer transaction concerned involved a commitment of more than \$10 by the consumer, no prior action by the commission is necessary.

I might point out that it does seem somewhat odd, if I might say so, for this committee to hold hearings on extensive consideration of a laundry list, trying its best to define carefully practices that should give rise to consumer class actions, and then at the end of that list to include any activity that does harm to consumers. It just seems a bizarre approach to take. You throw up your hands and say, we tried our hands at the list, we the Congress of the United States are not too happy with it and anything you say is all right with us. It does seem a rather odd approach to be taking in that provision.

Senator HART. That is sort of layer-like, isn't it?

Mr. DUNKELBERGER. I don't believe so.

Senator HART. Isn't that the way we draw instruments?

Mr. DUNKELBERGER. Not currently, anyway, Senator. I don't think so.

Certainly in your package and labeling bill, you did not take that approach. You were careful in specifying what you wanted the agencies to do and you didn't throw in a catchall clause saying anything else you want, is also unlawful.

Senator HART. I am thinking of the typical lawyer approach to an agreement. We speak of what we can do and then we make sure we haven't excluded anything.

Mr. DUNKELBERGER. But you have had 2 years to consider it here and for most legal documents you have a little less time.

In short, with respect to consumers the FTC's task in applying its administrative expertise to the evolution of definitions of the FTC Act's broad proscription of unfair or deceptive acts or practices appears to be transferred into the Federal courts. A consumer alleging that a deceptive practice was involved in a transaction in which he paid more than \$10 for the goods obtained can invoke the jurisdiction of the Federal courts on behalf of a class and require the court to determine, as a matter of first impression, whether the alleged deceptive practice in fact falls within the proscription of section 5(a) of the FTC Act.

At the least, this represents a new departure in theories of administrative law, and a new concept of the due process requirements that a law directly enforceable in court state with adequate specificity what is proscribed so that those subject to its proscriptions may be given the opportunity of avoiding transgression of the law.

In summary, we have grave doubts that in the overall balance of social interest a consumer class action jurisdiction in the Federal courts would prove more to the advantage than, the disadvantage of the consumer. If this committee concludes otherwise, we urge that you heed the warnings of the many students and practitioners of jurisprudence who have addressed the problem, and develop a screening device, like the triggering action in S. 1222, that will insure that the Federal courts are not inundated with frivolous and harassing suits.

Finally, we strongly urge that you strike subsection 101(1)(P) from S. 984, and leave the function of evolving a law of unfair or deceptive acts or practices to the Federal Trade Commission rather than attempting to render the Federal courts into administrative agencies.

Senator Moss. (Presiding.) Thank you, Mr. Dunkelberger.

I didn't get here until the very end of your testimony, but we are glad to have you before us again.

Is it your position that you are against the class action bill or do you simply think the canners ought to be exempt?

Mr. DUNKELBERGER. Let me explain very quickly. We have doubts about the class action technique, but we don't feel we are qualified to say there is no area that it might not be useful.

We do say the Food and Drug Act, which includes canned foods and other commodities, provides such a degree of intensive regulation and provides a rational basis for regulating these products that it does seem quite unnecessary, duplicative and really unjustified to establish the additional regulatory technique of the class action for these products.

The class action has been characterized, number one, as a means of regulation, and, two, a means of compensation. As I said, on the means of regulation, our products are regulated as intensively as any of those who have testified before you. In terms of compensation, we have very low cost items where injury from fraud, if it actually occurred, would be so small as not to justify any serious consideration of compensation.

We recognize that the \$10 limitation performs an important function of not providing for class action where you just have negligible losses.

So, in summary, we think where you do have intensive regulation, at least, you should not have class action authorization. Of course, the triggering device does not depend upon the \$10 limit.

There our principal concern in the laundry list is 101(P) which, as I said to Senator Hart, is as if Congress threw up its hands and said we worked for 2 years and more on a laundry list, and then threw up our hands and said anything is included as a potential for class action.

It is certainly a departure from prior bills and seems to be an unusual approach to be taken.

Senator Moss. We appreciate having your testimony and the point of view of the canners here as part of our record.
(The statement follows:)

STATEMENT OF EDWARD DUNKELBERGER

My name is Edward Dunkelberger; I am appearing as counsel for the National Canners Association, a nonprofit trade association of about 550 members from all parts of the country. Members of the Association pack approximately 85 to 90 percent of the national production of canned fruits, vegetables, juices, specialties, meat, and fish.

We appreciate this opportunity to appear before the Consumer Subcommittee to express our views on the consumer class action bills now under consideration by the Committee. The National Canners Association has repeatedly placed itself squarely on the record in support of reasonable legislation to benefit the consumer. We testified before this Committee, as well as the Senate Judiciary Committee and the Subcommittee on Commerce and Finance of the House Interstate and Foreign Commerce Committee, on earlier versions of this legislation in the 91st Congress. We are here this morning to offer comments on the specific bills before this Committee and to raise several points that we believe this Committee should consider carefully in its deliberations on the manner in which the goal of adequate and effective consumer protection may best be achieved.

The fundamental question presented here today—and it is a question the resolution of which may have broad ramifications for our social and judicial systems—is whether creating a class action jurisdiction in the Federal courts to hear consumer complaints constitutes a reasonable allocation of our judicial resources and the most effective distribution of our national resources for the protection of consumers.

Last year we noted in particular two dangers of the class action technique that we think merit your consideration. The first serious difficulty is the potential, too often realized, that the threat of a class action lawsuit and the attendant publicity and expense may be employed as a vehicle for harassment and coercion. The second and related concern is that the provision for attorneys' fees provides an incentive for the filing of suit in situations where the merits of the case would not otherwise justify it.

At the same time we recognize the legitimate interest of the proponents of this legislation in establishing an effective means of both discouraging fraudulent practices that victimize consumers and of compensating consumers who have suffered losses from such practices. For many types of products there may be few if any existing Federal regulatory programs that can be expected to achieve the goal of preventing fraudulent practices, and consumer class actions are seen as an across-the-board approach that could prove to be an effective deterrent. Equally important, the proponents maintain, is the need to prove a vehicle for compensating consumers who have suffered losses that are more than negligible but not sufficiently large to justify individual private action.

Society obviously has an interest in the existence of an effective means for the prevention of fraud and deceit and for compensating those found to be injured by such practices. But there is also a substantial public interest in discouraging frivolous, harassing or inconsequential litigation, which unduly clogs our judicial system, constitutes an unnecessary social cost, and threatens the economic life of the potential defendants.

To place our testimony today in perspective, we firmly believe that the degree of regulation applicable to food products—and in particular to canned foods—already strikes a reasonable and effective balance between the competing needs of the public. As was have indicated, we are not aware that the fraud and deceit said to give rise to a need for new consumer protection legislation can be found in the canning industry.

Indeed, the intensive regulatory controls embodied in the Federal Food, Drug, and Cosmetic Act provide a high degree of protection for consumers against fraud and deceit in food labeling and composition. The great bulk of canned foods are governed by definition and standards of identity, minimum standards of quality, and standard for fill of container. All of the labeling and adulteration prohibitions are backed up by strict criminal liability.

It was thought by Congress to be so important that our food supply be not adulterated and not misbranded that a violation without a showing of intent can lead to criminal liability. This novel aspect of that act—involving a significant departure from the traditional requirement that intent be a necessary element of any crime—has been explicitly upheld by the Supreme Court. We are now operating under that kind of regulation.

In addition, you can have seizure of violative products, and sweeping injunctive authority. The Wheeler-Lea amendments to the Federal Trade Commission Act provided special protection to consumers against false advertising of foods, drug, and cosmetics—including provision for preliminary injunctions and criminal penalties.

With this broad range of Federal controls against fraud and deception in the marketing of foods—most of which have their counterparts in State laws and regulations—we see no basis whatever for the canning industry being exposed to the potential harassment, expense, and publicity of class actions that cannot possibly provide consumer protection in as rational, comprehensive, and effective a manner as existing Federal and State regulatory controls.

Against this background, we believe that the requirement of S. 984 that, to become a member of the class in a class action suit, a consumer must have paid or become obligated to pay \$10 or more in the transaction resulting from the alleged deceptive act or practice is eminently reasonable. This is true not only because it will preserve the jurisdiction of the Federal courts against one spectrum of cases in which the individual loss involved is so small that its recovery cannot be said, in the balance of social interests and priorities, to weight heavily enough in the scale to justify the expenditure of judicial resources necessarily required, but also because it indirectly recognizes the existing intensive regulation that I have described.

Wholly aside from the point that subjecting our highly regulated industry to the terms of the bills before you would constitute a peculiarly wasteful and duplicative expenditure of social and judicial resources, we find that we must question whether as a matter of social policy application of this kind of attempted regulation is justified at all. We do not have an easy answer for this question and can only represent that we are deeply troubled, and that we believe that this is the most fundamental question raised by the subject matter you are investigating and that it should receive the intensive attention of the Committee.

When we last testified, we expressed concern on this point. Our concern has been intensified since that time by the expression of the views of eminent law professors, members of the bar, and jurists, as those views were represented before the Judiciary Committee last fall when that Committee considered the precursor of S. 984.

The greatest source of experience and expertise on the multitude of considerations surrounding this most basic determination is the Federal judiciary itself. Increasingly in recent years, the class action has been sought to be employed as a litigating technique and has presented to the courts the question of in what circumstances it is a viable technique. In a number of cases, the courts have responded by disallowing the class action because, pragmatically, they were simply unmanageable.

While it is a general policy of the judiciary not to take a position on proposed legislation that would affect the jurisdiction of the courts, it does not appear that this should entirely prohibit this Committee from gaining the benefit of the wealth of knowledge and experience possessed by the judiciary in this area. It would not appear in appropriate to elicit the views of judges on the general problems posed by the class action suit, without reference to particular legislation, that this Committee might better understand the difficulties adverted to by so many witnesses.

The two witnesses with practical judicial experience submitting statements to the Judiciary Committee last year—Simon Rifkind, who sat as a Federal district judge from 1941 to 1950, and Judge Murrah, who is director of the Federal Judicial Center—expressed grave concern that the class action provisions of S. 3201, without more, might not constitute a viable consumer protection device. They pointed to the complexities, the expense, and the time involved in managing a class action as constituting a serious drain on judicial resources. Judge Rifkind eloquently summarized the danger he foresaw:

"Any study of the Byzantine complexity of the cases now pending under Rule 23 will confirm the apprehension that lawsuits under [this bill] will be not only numerous but also extraordinarily demanding of judicial resources.

* * * * *

"Predictions of Gotterdamerung are not lightly to be made. But the motivation [this bill] creates for the filing of consumer class actions, the liberal standards it sets for such suits, and the demands sizable numbers of such suits would impose upon our district courts point inevitably to the conclusion that one of two things would happen. A considerable number of federal courts, including almost certainly the now crowded courts in our larger cities, would be quickly pinioned under the weight of these cases, unable to dispose of their other duties. Or the courts, to protect themselves, would be forced to distort the act to deny class suitors access to the courts. The former would be disastrous. The latter would be bad law and would leave consumers no better off than before." *Hearings Before the Senate Committee on the Judiciary*, 91st Cong., 2d Sess., at 381.

Judge Murrah, as well, observed that a class action jurisdiction uninhibited in any way "can really breed chaos in the courts. . . ."

Nor was this Committee oblivious to the dangers and inadequacies of the class action technique. In the Report accompanying S. 3201, you candidly stated that "class actions are complicated and time consuming," and that "it may take a class of consumers years to obtain relief." S. Rep. No. 91-112, 91st Cong., 2d Sess., August 14, 1970.

Where do these considerations lead? Fundamentally, they present the question whether the class action lends itself as a viable technique for regulation—because what you are really talking about here, without further limitations on the scope of these bills, is an attempt at regulation. You are permitting very small individual claims into the courts, and the small individual recoveries that will be had if the class proves victorious, diminished by the costs of litigation, will not be significantly compensatory. The real question involved here is whether, by placing this regulatory task in the hands of the courts, you are giving the consumer the best buy for his money—or even a reasonable buy—in terms of Government. It appears that the real objective of consumer protection in this area—the only possible truly effective objective—should be preventive and not remedial. The regulatory structure necessary for sound consumer protection already exists—you, the Congress, have already created it. If the Congressional directive contained in so many regulatory statutes in the last 40 years has not been effectively implemented, perhaps the resources we are deliberating on today should be allocated to providing the necessary funds and man power to our regulatory agencies to permit them to do the job—a job of preventing the small frauds for which remedial solutions are not satisfactory solutions.

If, after its deliberations, this Committee concludes that the class action does have a potential as a vehicle for consumer protection, at the least you should frame legislation in a manner that respects the unavoidable difficulties that will be presented and is designed to protect in some measure the jurisdiction of the Federal courts from the frivolous and the harassing case. It is most often the early stages of class actions—the procedural elements of the case involving definition of a clause, providing adequate notice to its members, etc.—that are most burdensome, time-consuming, and expensive. These come before the merits are reached.

One reasonable limiting device to insure that it is the significant cases for which the jurisdiction is exercised is employment of the so-called "trigger" provided for in S. 1222 and in section 102(a) of S. 984. Other methods will undoubtedly be advanced. Our concern is to bring to the attention of this Committee the need for careful deliberation of these limitations in finding the balance that must be struck between the society's essential requirement of a sound allocation of judicial resources, which is of direct benefit to every individual member of the society, and its consumer production needs, if the Committee concludes that a class action jurisdiction is to be created. In this balance, as Judge Murrah urged, there must be *some* kind of screening device.

In addition, a provision that commends itself to any ultimate bill that this Committee might agree upon is that found in section 6(b) of S. 1378, which

gives to the Federal court in any action brought under the consumer class action jurisdiction the final discretion to determine, in all of the circumstances, whether it is appropriate and in the best interests of all concerned that the case be entertained. This discretion would permit the court to establish criteria applicable to the particular variety of cases sought to be brought within the class action jurisdiction, without, in protecting their jurisdiction, having to do violence to the principles of Rule 23 of the Federal Rules of Civil Procedure, and thereby potentially undermining the liberal construction of that rule that now applies for class actions brought within one of the traditional jurisdictions of the court.

Turning from the general to the particular, if this Committee decides that a consumer class action jurisdiction is warranted, and that in defining the scope of that jurisdiction the "laundry list" approach of S. 984 should be adopted, we believe that there are several respects in which the language of S. 984 should be improved to avoid vagueness and ambiguity, and to give fair warning to those who will be subject to the bill's provisions of what they are proscribed from undertaking. Many of these problem areas we pointed out to the Committee in our testimony last year.

The terms "grade" and "quality" in subsection 101(1) (F), for example, are quite troublesome, since they may include within their connotation representations of opinion, taste or subjective evaluation of a product. Certainly, a manufacturer or seller should not be exposed to damage actions merely because some consumers—or even a trier of fact—might differ with his non-objective description of a product as having a "good taste," a "pleasant fragrance," or "satisfying texture."

Of far greater concern, however, are the provisions of subsection 101(1) (P). This subsection is new, and the radical change it authorizes in the administration of section 5(a)(1) of the Federal Trade Commission Act cannot be viewed lightly.

By subsection (P), S. 984 declares an "unfair consumer practice," that may be made the basis of a class action in Federal court, "any . . . act or practice which is unfair or deceptive to a consumer and is prohibited by section 5(a)(1) of the Federal Trade Commission Act. . . ." There is no requirement of a prior FTC determination that the act or practice is violative of section 5(a) of the FTC Act, and where the individual consumer transaction concerned involved a commitment of more than \$10 by the consumer, no prior action by the Commission is necessary.

In short, with respect to consumers the FTC's task in applying its administrative expertise to the evolution of definitions of the FTC Act's broad proscription of "unfair or deceptive acts or practices" appears to be transferred into the Federal courts. A consumer alleging that a deceptive practice was involved in a transaction in which he paid more than \$10 for the goods obtained can invoke the jurisdiction of the Federal courts on behalf of a class and require the court to determine, as a matter of first impression, whether the alleged deceptive practice in fact falls within the proscription of section 5(a) of the Federal Trade Commission Act. At the least, this represents a new departure in theories of administrative law, and a new concept of the due process requirements that a law directly enforceable in court state with adequate specificity what is proscribed so that those subject to its proscriptions may be given the opportunity of avoiding transgression of the law.

In summary, we have grave doubts that in the overall balance of social interest a consumer class action jurisdiction in the Federal courts would prove more to the advantage than the disadvantage of the consumer. If this Committee concludes otherwise, we urge that you heed the warnings of the many students and practitioners of jurisprudence who have addressed the problem, and develop a screening device, like the triggering action in S. 1222, that will insure that the Federal courts are not inundated with frivolous and harassing suits. Finally, we strongly urge that you strike subsection 101(1) (P) from S. 984, and leave the function of evolving a law of unfair or deceptive acts or practices to the Federal Trade Commission rather than attempting to render the Federal courts into administrative agencies.

Senator Moss. We have now completed the list of witnesses that we were scheduled to have.

We thank all of them.

I was here at the beginning and here at the end, but I missed some of the interim testimony. I will read it carefully in the record.

The record will remain open for at least a week.

If there is anyone who has not been able to present his material and still wants to do it in writing, he may submit it to the Committee. We will see that it is made part of the record and is considered by the Committee when we get down to marking up the bill and to determining whether we are going to report a bill.

Is there anyone here today who was not heard?

Thank you all for coming and for remaining for this hearing. This is an important, if controversial, matter and one that we want to handle with the greatest of care to make sure that we do not cause any disruption or problems that are unnecessary; at the same time we are anxious, of course, to extend the widest possible protection to consumers from fraud and misrepresentation and any other injury that may come from their participation in the market.

We will now stand adjourned subject to the call of the Chair.

(Whereupon, at 3:33 p.m., the hearing was adjourned, subject to the call of the Chair.)

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

AMERICAN MUTUAL INSURANCE ALLIANCE,
WASHINGTON OFFICE,
Washington, D.C., May 3, 1971.

Hon. FRANK E. MOSS,
Chairman, Senate Commerce Committee,
Consumer Affairs Subcommittee,
5202 New Senate Office Building,
Washington, D.C. 20510

DEAR SENATOR MOSS: The American Mutual Insurance Alliance is a voluntary association of over 100 mutual property and casualty insurance companies. Our member companies write in excess of 3 billion dollars in premiums, annually, in all lines of property and casualty insurance, in all fifty states and the District of Columbia.

We would like to take this opportunity to comment upon Section 101(6) of S. 984, the Consumer Class Action Act of 1971 which is now pending before your subcommittee. Under the provisions of this title, certain specified unfair or deceptive practices in the offering or advertising of "goods or services" are made unlawful. The definition of "services" in Section 101(6) of the bill includes, specifically, "insurance services."

Anyone engaging in these specified unfair or deceptive practices will be subject to cease and desist proceedings by the Federal Trade Commission, and if these proceedings are successful, there could follow civil class actions suits by consumers. Additionally, under other provisions of the bill, if a consumer has paid an amount greater than \$10 in any transaction as a result of such "unfair consumer practice," he could bring a class action suit on behalf of others without awaiting prior governmental action, provided he has given the Federal Trade Commission 90 days notice of the alleged violation.

Our concern is with respect to the inclusion of "insurance services." We feel that this is inconsistent both with the intent of Congress in enacting the McCarran-Ferguson Act (15 USC 10 11-1015) and also with respect to legislative action which has been taken in all states concerning unfair or deceptive trade practices in the insurance business.

The McCarran-Ferguson Act was enacted by Congress in 1945 as a direct result of a decision of the United States Supreme Court in the *United States v. Southeastern Underwriters Association* 322 US 533 (1944), in which it was held that insurance is commerce, and as such, subject to regulation by the federal government.

This produced serious confusion which the Congress intended to eliminate by passage of the McCarran-Ferguson Act. It specifically expressed this intent in the provisions of the Act by stating that the continued regulations by the states of the business of insurance was in the public interest and that such regulation should continue to be the responsibility of the states, and not the federal government.

The Act further specifically states that the Sherman, the Clayton and the Federal Trade Commission Acts shall be applicable to the business of insurance only to the extent that such business is not regulated by state law.

The provisions of the McCarran-Ferguson Act make it clear that Congress intended that the states should be responsible for regulation in this area, and that the federal law should not apply to the extent that the states did in fact adopt such regulations.

In these areas, unfair and deceptive trade practices, all of the states have exercised their authority to regulate. In every jurisdiction, there is now included as part of the state insurance code, the model state Fair Trade Practices Act. This Act is patterned after the Federal Trade Commission's Act, and contains the same prohibitions against all "unfair methods of compensation or unfair or deceptive acts or practices." It has been held that the existence

of these state laws makes Section 5 of the Federal Trade Commission inapplicable to insurance. *Federal Trade Commission v. National Casualty Company*, 357 US 560 (1958).

It is clear that the states, in enacting the model State Fair Trade Practices Act, have followed the express intent of Congress to provide regulation in this area. The inclusion of "insurance services" in Section 101(6) of S. 984 would produce an inconsistency and overlapping of regulation with the actions of the several states. The model States Act cover the specific practices specified in S. 984 and indeed are much broader.

We feel that if the reference to "insurance services" is permitted to remain in S. 984, it will produce a confusing situation of duplicating state and federal regulations. We feel there is no need to produce this since the states are already effectively regulating in these areas.

We feel there are equally persuasive reasons for excluding "insurance services", in that these are already effectively regulated, as there is to exclude "credit" and "motor carriers services."

We are also concerned with Section 3(e) of S. 1378, also pending before your subcommittee. This section also includes "insurance services" in the definition of "services." The "unfair consumer practices" specified in S. 1378 are all practices which are now subject to the model State Fair Trade Practices Act in the insurance field and, if enacted, would also produce duplication between state and federal regulations.

The conflict likely to arise if either S. 984 or S. 1378 is enacted into law has been recognized in Section 2(f) (1) of S. 1222, pending before your subcommittee. We would respectfully suggest that if any action is taken on either S. 984 or S. 1378 that the same treatment be given to "insurance services" as has been given in S. 1222.

We would very much appreciate if this letter could be made part of the official hearing record.

Sincerely,

ANDRE MAISONPIERRE,
Vice President.

STATEMENT OF JOSEPH M. BELTH

I am Joseph M. Belth, professor of insurance, Graduate School of Business, Indiana University, Bloomington, Indiana. I am author of *The Retail Price Structure in American Life Insurance* and various other studies in the area of life insurance price measurement. I am not being compensated for the preparation of this statement. The views expressed in the statement are my own and not necessarily those of any institution, organization, or other individual.

I. INTRODUCTION

Life insurance contracts generally are long-term financial instruments that perform useful functions in our society. In my opinion, however, the sales and advertising practices of life insurance companies sometimes are deceptive. The purpose of this statement is to illustrate and comment upon a variety of such practices.

At the outset, I would like to explain what I mean by the word "deceptive." In my view, a presentation is deceptive if it tends to give the recipient an erroneous impression of important relationships. The emphasis in this definition is on the recipient. When I describe a life insurance advertisement or sales presentation as deceptive, I do not intend to suggest that the deception is necessarily deliberate on the part of the life insurance company or agent.

II. BACKGROUND

Except at very young ages, the likelihood of death increases as age increases, and with increasing rapidity. Life insurance sometimes is written on a one-year renewable term basis, with premiums increasing in a manner designed to offset the increasing likelihood of death. Under such an arrangement, however, the insurance company experiences a phenomenon called "adverse selection," in which policyholders with deteriorating health tend to renew their policies and policyholders in good health tend to discontinue their policies. This adverse selection leads to a deterioration in the "quality" of the group, and to a larger

than anticipated number of death claims relative to premium payments. An attempt to anticipate the adverse selection by more rapid premium increases tends to aggravate rather than solve the problem.

Level-premium life insurance, under which the premium remains constant, is a technique adopted by the life insurance industry in an attempt to minimize adverse selection and at the same time make it financially feasible for policyholders to continue their protection even to advanced ages. Such an arrangement, however, requires that the policyholder be overcharged (relative to mortality costs, expenses, and profit) in the early policy years to offset the inadequacy of premiums in the later policy years. The level-premium arrangement and the legislation requiring cash values make life insurance companies major financial institutions and transform what would otherwise be an insurance transaction into a combination or package transaction involving both insurance protection and a savings medium.

Because of the package aspect of cash-value life insurance contracts, it is necessary to distinguish between the "premium" for the contract and the "price" of the protection element of the contract. To compute the price of the protection element, it is necessary to separate the protection element of the policy from the savings element, at least in a theoretical sense. Since the separation involves the making of assumptions, no single price figure can be established as *the* price; rather, any price figure must be accompanied by a statement concerning the assumptions used in computing that figure.

The nature of a life insurance price figure may be illustrated by an analogy. Assume that an individual is purchasing a package AB that consists of an item A and an item B. When only the price of the package AB is given, no single figure can be established as the price of either A or B alone. To calculate the price of A, it is necessary to make an assumption about the price of B, and vice versa. Thus, any figure established as the price of A must be accompanied by a statement about the assumed price of B, and vice versa.

In life insurance, the two parts of the package are protection and savings, and any figure established as the price of the protection must be accompanied by a statement about the assumed rate of return on the savings element. Conversely, it is possible to make a statement about the rate of return on the savings element only if an assumption is made about the price of the protection. In short, the price of protection and the rate of return on the savings element are two sides of the same coin, and either can be used to make comparisons among policies.

III. CLASS A PRACTICES

For the purposes of discussion, I have divided the various practices described in the remainder of this statement into three categories. I have designated these as Class A, Class B, and Class C practices.

Class A practices are those that involve a misallocation of the interest factor. Since the complexity of life insurance is a major barrier to an understanding of the full implications of Class A practices, I have developed a simple analogy that strips away the complexity and illustrates the fundamental problem.

The savings account analogy

Assume that an individual puts \$1,000 per year into a savings account, and that the account is credited annually with 5 percent interest. The growth of the account over a period of ten years is shown in Table 1, with the figures rounded to the nearest dollar.

TABLE 1.—GROWTH OF \$1,000 PER YEAR AT 5 PERCENT INTEREST

Year	Deposit at beginning of year	Interest credited for year	Amount in account at end of year
1	\$1,000	\$50	\$1,050
2	1,000	103	2,153
3	1,000	158	3,310
4	1,000	216	4,526
5	1,000	276	5,802
6	1,000	340	7,142
7	1,000	407	8,549
8	1,000	477	10,027
9	1,000	551	11,578
10	1,000	629	13,207

Consider the tenth year. The saver starts the year with \$11,578 and adds \$1,000 to it. At the end of the year, his account is credited with interest of \$629 (5 percent of \$12,578), making his account \$13,207 at the end of the year. Of the \$629 interest in the tenth year, \$50 is attributable to the tenth year's deposit of \$1,000, and the other \$579 is attributable to the previous deposits made during the first nine years.

In my opinion, it is deceptive to state, suggest, or imply that the \$629 of interest in the tenth year is attributable in its entirety to the tenth year deposit of \$1,000. In other words, the rate of return here is 5 percent, and I regard as deceptive any presentation that states, suggests, or implies that the saver is earning 62.9 percent interest on his tenth year deposit of \$1,000. This form of deception is the basic characteristic of each of the Class A practices described below.

The Harris Article

In the February 1970 issue of *Life Insurance Selling* magazine, there is an article by Richard F. Harris, Jr., entitled "I Tell Corporations, 'Put the Difference in Permanent.'" The article is reproduced in Appendix A.

In this article, \$989 per year is the difference between a decreasing term premium and a straight life premium. Mr. Harris attributes the full amount of the cash-value increase in any given year to the \$989 difference paid in that year. For example, in the tenth year, he shows an "annual increase in assets" of \$1,427. He attributes that increase to the \$989 difference paid in the tenth year, and then he shows the "annual % tax free profit" that year as 44.3 percent.

The cash surrender value of the straight life policy at the end of thirty years is \$45,134. Implicit in the relationship between a \$989 annual deposit and an accumulation of \$45,134 at the end of thirty years is an annual interest rate of about 2.6 percent. If an adjustment were made for the different amounts of protection under the decreasing term policy and the straight life policy, the implicit annual interest rate would be about 3.8 percent. Such rate-of-return figures are not mentioned in the Harris article. Instead, after a negative figure in the first year, the "annual % tax free profit" figures range from 15.6 percent in the second year to 77.5 percent in the thirtieth year. These figures correspond to the figure of 62.9 percent used in the savings account analogy.

Mr. Harris denies that he is discussing compound interest. Actually, the question of simple versus compound interest is a relatively minor part of the problem here. Consider the savings account analogy. Of the \$629 interest in the tenth year, \$500 is attributable to the ten deposits themselves (5 percent of \$10,000), and \$129 is attributable to interest on the interest on the nine previous years' deposits. In other words, about one fifth of the interest in the tenth year is attributable to the effect of compound interest.

The sales presentation described in the Harris article involves the misallocation of the interest factor in such a way as to overstate the rate of return on the savings element. In my opinion, the presentation is deceptive.

The Provident Life and Accident Advertisement

In the April 1970 issue of *Life Insurance Selling* magazine, there is an advertisement by the Provident Life and Accident Insurance Company Chattanooga, Tennessee. The advertisement is reproduced in Appendix B.

Consider the third policy year. The annual premium is \$1,689. The cash value increases by \$1,700—from \$1,800 at the end of the second year to \$3,500 at the end of the third year. The cash-value increase is subtracted from the annual premium, and the advertisement shows a third net year cost of *minus* \$11.

Comparing the full amount of one year's cash-value increase with that year's premium is similar to comparing the full amount of one year's increase in a savings account with that year's deposit. When a reasonable allocation of the interest factor is made (by assuming 5 percent, for example), the third year net cost is \$163 rather than *minus* \$11. In the seventh year, the net cost (again assuming 5 percent interest) is \$403 rather than *minus* \$111. The manner in which the above figures of \$163 and \$403 are calculated is explained later.

The Provident Life and Accident advertisement involves the misallocation of the interest factor in such a way as to understate the price of the protection. In my opinion, the advertisement is deceptive.

The Ledger Statement

Many companies utilize the so-called ledger statement as a part of their sales material. An example is reproduced in Appendix C, which shows the form of ledger statement currently used by the Acacia Mutual Life Insurance Company.

In this case, the "annual net payment" each year is determined by subtracting the annual dividend from the annual premium. Then the "cash value increase during the year" is subtracted to arrive at the "annual net cost or gain." By the tenth year, the latter figure is a "gain," or negative cost. In that year, for example, the "annual net cost or gain" is a "gain" of \$87 (or, stated another way, an "annual net cost" of *minus* \$87).

The effect of this presentation is similar to the effect of the Harris article and the Provident Life and Accident advertisement described above. Actually, a substantial portion of the \$2,100 cash-value increase in the tenth year is attributable to interest on the savings element developed during the first nine years. When a reasonable allocation of the interest factor is made (by assuming 5 percent interest, for example), the cost of insurance in the tenth year is \$880 rather than *minus* \$87. The manner in which the above figure of \$880 is calculated is explained later.

Such ledger statements involve the misallocation of the interest factor in such a way as to understate the price of the protection. In my opinion, such presentations are deceptive.

An Alternative

Since the price-of-protection understatement (or rate-of-return overstatement) in the above illustrations results from a misallocation of the interest factor, all that is needed is a reasonable allocation of the interest factor. This can be accomplished easily. Consider, for example, the tenth year in the Acacia Mutual ledger statement. The *minus* \$87 cost shown in the statement can be calculated by the following formula:

$$P + CVP - CVC - D = C$$

where P is the premium for the year, CVP is the cash value at the end of the preceding year, CVC is the cash value at the end of the current year, D is the dividend for the year, and C is the cost for the year. In other words,

$$\$2,448 + \$16,900 - \$19,000 - \$435 = \$-87.$$

A reasonable allocation of the interest factor may be accomplished by changing the formula to read as follows:

$$(P + CVP)(1 + i) - CVC - D = C$$

where i is the assumed interest rate expressed as a decimal, and all the other items are the same as in the earlier formula. For example, if 5 percent is the assumed interest rate,

$$(\$2,448 + \$16,900)(1 + .05) - \$19,000 - \$435 = \$880.$$

It would be necessary to identify the interest rate associated with such yearly cost figures. For example, the above figure of \$880 should be identified as the tenth year's cost of protection, assuming 5 percent interest. I feel that this is a reasonable way in which to illustrate the price of protection, and that such an approach would remove the element of deception inherent in the various Class A practices.

IV. CLASS B PRACTICES

Class B practices are those that involve comparisons based upon the simple addition of dollar amounts payable at different points in time. Here again, an analogy may be used to illustrate the fundamental problem.

The Work Contract Analogy

Let's assume that Jones retained Smith to do a particular job, with the understanding that upon completion Smith would be paid \$1,000 per year for forty years, a total of \$40,000. After the job is completed, Smith asks Jones to begin the payments, and Jones says:

"Smith, you've done such a great job that I'm going to pay you 10 percent more than we had agreed upon. I'm going to pay you \$600 per year for thirty years and then \$2,600 per year for the final ten years. That's a total of \$44,000, which is 10 percent more than the \$40,000 I originally agreed to pay you."

Hopefully Smith would see that Jones has failed to take interest into account.

For example, let's assume that Smith puts each payment into a savings account that earns 5 percent, compounded annually. Under the original payment plan (\$1,000 per year for forty years), he would have \$126,840 in the account at the end of the forty years. Under the modified payment plan that Jones proposed, however, Smith would have only \$102,518 in the account at the end of the forty years.

In my opinion, it is deceptive to state, suggest, or imply that the original payment plan is 10 percent better than the modified payment plan. In other words, what Jones described as an arrangement providing 10 percent more for Smith actually provides 19 percent less, assuming 5 percent interest. This form of deception is the basic characteristic of each of the Class B practices described below.

The Cooley article

In the May 1970 issue of *Life Insurance Selling* magazine, Harold P. Cooley provides some suggested responses to a number of common objections encountered in the sale of life insurance. In one part of the article, Mr. Cooley describes a possible response to the statement that "I believe in buying term and investing the difference." The article is reproduced in Appendix D.

Mr. Cooley compares a \$10,000 level term to 65 contract for a man aged 30 with a \$10,000 life paid-up at 65 contract. The policies have annual premiums of \$99.70 and \$224.20, respectively. Mr. Cooley assumes that the premiums for the life paid-up at 65 contract are paid for ten years and that the policy then goes on extended term insurance for an additional twenty-four and a fraction years. For purposes of the discussion that follows, I assumed that the period of extended term is exactly twenty-five years.

Mr. Cooley adds up the ten premiums for the life paid-up at 65 contract, subtracts the simple total of the first ten years' dividends, and then divides the remainder by 35 in order to obtain an average yearly cost. The result is \$52.71 per year—a figure that Mr. Cooley describes as "about half the [\$99.70] cost of term to 65."

Mr. Cooley's analysis does not take interest into account. When an assumed interest rate of 5 percent is applied to this situation, the average yearly cost of the ten years' premiums (minus the ten years' dividends) for the life paid-up at 65 contract and the twenty-five years of extended term insurance is \$89.04. This is in contrast to Mr. Cooley's figure of \$52.71. Although the interest-adjusted figure of \$89.04 is below the \$99.70 term premium, the difference is much smaller than suggested by Mr. Cooley.

The sales presentation described by Mr. Cooley fails to consider the interest factor and thereby distorts the relationship between two markedly different premium payment arrangements. In my opinion, the presentation is deceptive.

The Brinton talk

In September 1970, at the annual meeting of the National Association of Life Underwriters, Dilworth C. Brinton, C.L.U., gave a talk on the advantages of straight life over term insurance. An article describing the talk appeared in the September 16, 1970, issue of *The National Underwriter*. The article is reproduced in Appendix E.

Mr. Brinton indicated that, for a \$100,000 straight life policy issued at age 25 and continued to age 65, the "net return over cost" is \$30,923. That he indicated that, for a \$100,000 one-year renewable term policy over the same period, the "cost of term insurance" is \$34,579. Finally, he stated that the "total difference" in favor of the straight life policy is \$65,502. (The above "cost of term insurance" and "total difference" figures differ from those in Mr. Brinton's talk by \$35, because I was unable to reproduce precisely his "cost of term insurance" figure.)

Mr. Brinton's analysis does not take interest into account. His straight life "net return over cost" figure was calculated by adding up the forty years' premiums, subtracting the simple total of the forty years' dividends, subtracting the cash value at the end of the forty years, and subtracting the surrender dividend payable at the end of the forty years. His "cost of term insurance" figure was calculated by adding up the forty years' premiums and subtracting the simple total of the forty years' dividends.

When an assumed interest rate of 5 percent is applied to this situation, the "cost" of the straight life policy in present-value terms is \$9,163, and the "cost" of the term policy is \$9,733. These figures still favor the straight life policy, but by \$570, as compared with Mr. Brinton's figure of \$65,502.

The sales presentation described by Mr. Brinton fails to consider the interest factor and thereby distorts the relationship between two markedly different kinds of life insurance contracts. In my opinion, the presentation is deceptive.

The traditional net cost method

The most frequently used technique for illustrating the price of life insurance is the traditional net cost method. This method serves as the basis for the price information contained in the most widely disseminated volume of life insurance policy data—A. M. Best Company's *Flitcraft Compend*.

Frequently a twenty-year period of analysis is used. The simple total of the dividends for the twenty-year period and the cash surrender value payable at the end of the twentieth year are subtracted from the simple total of the premiums for the period. The remainder is divided by 20 (the number of years in the period of analysis), and the result is the twenty-year average net cost.

The method may be illustrated with the figures shown in Appendix C. The premiums are \$2,448 per year; thus the simple total of twenty years' premiums is \$48,960. The simple total of the first twenty years' dividends is \$8,441, and the cash value at the end of the twentieth year is \$39,500. The twenty-year average net cost, determined by subtracting the dividends and the cash value from the premiums and dividing the remainder by 20, is \$50.95, or 51 cents per \$1,000 of face amount.

The twenty-year average net cost also may be calculated by adding the first twenty "annual net cost or gain" figures in Appendix C, and then dividing by 20. In this sense, the twenty-year average net cost figure embodies the entire series of price understatements reflected in the "annual net cost or gain" figures.

The traditional net cost method does not simply understate the price of protection. It also distorts comparisons. For example, since the simple total of dividends is used in the calculations, companies are encouraged to "steepen" their dividend scales. A company is said to have a steeper scale than another company when the former pays smaller dividends in the early policy years and larger dividends in the later policy years than the other company. When a company steepens its dividend scale, it not only benefits from increased interest earnings by deferring the payment of larger dividends, but also it benefits from the fact that many policyholders will either die or discontinue their policies before receiving the larger dividends in the later years.

The traditional net cost method combines figures in such a way as to understate the price of protection and to distort comparisons among policies. In my opinion, the method is deceptive.

The Alternatives

The various Class B practices involve the simple addition of dollar amounts payable at different points in time. The result is an understatement of the price of protection and a distortion of the relationships among policies. The problems stem from a failure to consider the interest factor and a failure to consider the relative probabilities of the various dollar amounts being paid or received by the policyholder.

One alternative is to recognize just the interest factor. The Report of the Joint Special Committee on Life Insurance Costs, which was released in May 1970, contained such a recommendation. The committee was appointed in January 1969 by the American Life Convention, the Institute of Life Insurance, and the Life Insurance Association of America. It was a high level industry committee, and it was chaired by E. J. Moorhead, then president-elect of the Society of Actuaries.

The committee concluded that "Allowance should, in our opinion, be made in the cost index for time because the value of money in terms of the interest it can earn is too important to ignore." The committee recommended the use of the "interest-adjusted method." This method differs from the traditional net cost method in that the interest factor is taken into account. The committee also suggested that "Currently a rate of 4% per year seems generally suitable." Copies of the committee report are available from the Institute of Life Insurance (277 Park Avenue, New York, New York 10017). Also, The National Underwriter Company (420 East Fourth Street, Cincinnati, Ohio 45202) has published a volume called *Cost Facts on Life Insurance*, which shows figures for many policies based on the interest-adjusted method and 4 percent interest.

Another alternative is to recognize not only the interest factor but also the relative probabilities of the various dollar amounts being paid or received by the policyholder. The above-mentioned committee concluded that such probabilities

should not be introduced into the calculations, but it is feasible to do so. The techniques are explained in my paper, "The Relationship Between Benefits and Premiums in Life Insurance," which appeared in the March 1969 issue of the *Journal of Risk and Insurance*.

In my opinion, the second of the two alternatives is preferable. However, I feel that a recognition of just the interest factor is a reasonable approach, and that such recognition would remove the element of deception inherent in the various Class B practices.

V. CLASS C PRACTICES

Class C practices are those involving presentations that are simply false. Although they do not involve a misallocation or an omission of the interest factor, their falsity usually is difficult to detect because they are complex and tricky. Two examples of such practices are presented below.

In the November 1969 issue of *The Radiator* (the magazine of the Massachusetts Mutual Life Insurance Company), there is an article by Raymond L. Paul, C.L.U., entitled "Why Get Complicated?" The article is reproduced in Appendix F.

Mr. Paul suggests a technique for handling the question of investment return when it arises in the sales interview. He concludes that the buyer of a straight life policy is getting "\$50,000 of death protection for \$40 a year."

There are several flaws in Mr. Paul's suggested technique, but I will mention only the major one. If we accept all of the figures in the article, the life insurance buyer would forgo \$440 of interest each year for each \$1,000 invested in the life insurance policy. In the first year the amount forgone would be \$40. In the second year, however, even disregarding compound interest, the amount forgone would be \$80, because he would be forgoing the extra interest on the first year's \$1,000 as well as the second year's \$1,000. By the same token, and again disregarding compound interest, he would forgo \$120 in the third year. In other words, while the technique suggested by Mr. Paul refers to \$50,000 of death protection for \$40 a year, the actual figures (disregarding compound interest) should be \$40 in the first year, \$80 in the second year, \$120 in the third year, \$400 in the tenth year, \$800 in the twentieth year, and so forth.

The sales idea presented by Mr. Paul is both false and tricky. In my opinion, it is deceptive.

The Wolfe Technique

In his book *See You Next Week* (published by The Research & Review Service of America, Inc.), Wayne W. Wolfe suggests a technique to persuade a term insurance policyholder to convert to straight life. The presentation is reproduced in Appendix G.

Let's assume that the policyholder is aged 30, that he is paying \$300 per year for \$50,000 of term insurance, and that he would pay \$1,000 per year for straight life if he converts. With these figures, Mr. Wolfe suggests that the policyholder would be investing his money at 30 percent interest if he converts the term policy to straight life.

The major flaw in Mr. Wolfe's suggested technique is similar to the one in Mr. Paul's presentation. In the first year, the \$300 term premium would be 30 percent of the straight life premium. In the second year, however, even disregarding compound interest, the \$300 term premium would be 15 percent of the \$2,000 paid into the straight life policy. By the same token, and again disregarding compound interest, the figures would be 10 percent in the third year, 3 percent in the tenth year, 1½ percent in the twentieth year, and so forth.

The sales idea presented by Mr. Wolfe is both false and tricky. In my opinion, it is deceptive.

VI. CONCLUSION

Practices of the type described in this statement are widespread in the life insurance industry. Material of the type illustrated in Appendixes A, B, D, E, F, and G appears sporadically. Premium notices that show the increase in cash value for the year, thus by implication understating the price of protection for the year, are used by some companies. Ledger statements of the kind illustrated in Appendix C are used by many companies. The traditional net cost method of illustrating the price of protection is widely used.

Knowledgeable people in the life insurance industry are aware of the questionable practices described in this statement. By and large, however, they seem willing to live with such practices. Among their rationalizations are the following:

(1) All the life insurance companies use these practices, so we must use them to stay competitive.

(2) Life insurance is a desirable service and it is very hard to sell, so we are justified in using these practices to get people to buy.

(3) The money a person puts into life insurance would otherwise be kept in a non-interest-bearing checking account or would be frittered away, so it is reasonable to ignore the interest factor.

(4) It would make the sales presentation considerably more complicated if we were to recognize the interest factor.

(5) There has been no discernible public demand for an abandonment of these practices.

(6) We are closely supervised by the various state insurance departments, but none of them has challenged us concerning these practices.

In my opinion, these rationalizations add up to an abdication of responsibility by the life insurance industry and the state regulatory agencies. It is possible that either the industry itself or the state regulatory agencies could correct the situation, but there has been little progress to date.

The high level industry committee referred to earlier has recommended the inclusion of the interest factor in cost comparisons, and The National Underwriter Company has published a volume containing interest-adjusted cost figures for many policies. To my knowledge, however, only one company—Bankers Life Company, Des Moines, Iowa—has taken any action in the thirteen months since the committee report was released, and apparently there has been no action taken by any of the state insurance commissioners.

The draft of S. 984, in Section 101(6), defines "services" to include "insurance services." Also, the practices described in this statement presumably would be deemed "unfair consumer practices" under Section 101(1) (P) and perhaps under Section 101(1) (J). In view of the seriousness of these practices, I would like to suggest that the bill continue to encompass insurance unless the National Association of Insurance Commissioners agrees to (1) adopt a model bill or regulation dealing specifically with these practices and (2) press for the enactment or promulgation of such a model bill or regulation by the various state legislatures or insurance commissioners.

Thank you.

APPENDIX A

By R. F. "DICK" HARRIS, JR.

American General Life Insurance Company
Houston*"Buy term and invest the difference"*

I Tell Corporations, "Put the 'Difference' in Permanent"

IN RECENT months I have received a number of inquiries—some have been almost attacks—concerning a concept I have developed and presented in speeches and sales congresses around the country.

I call the concept "corporations should buy term and invest the difference . . . in permanent," and the difficulty arises in the part of the presentation that deals with a corporation's return on capital.

In order to set the record straight, and also to share the idea with additional life underwriters, I would like to present the concept here with special emphasis on the "return on capital" portion.

The concept grows out of the evolution that is taking place in our business, including the evolution taking

place in marketing concepts. One example is that of the corporation head who says, "We're going to buy term and invest the difference." We've always heard that, but in years gone by I attempted to change the executive's mind. Now, however, I let the corporation have the term, rather than attempting to argue with the head of the company. Then when I deliver the term policy, I begin the following discussion:

"Sir, does your corporation intend to keep that term policy?"

In Texas he replies, "Is a bluebird blue?"

Then I say, "Now that your corporation has bought the term insurance, where are you going to invest the difference?"

His answer is, "In our corporation,

Richard F. "Dick" Harris, Jr., better known in the life insurance business as "\$Cash\$," entered the business in Atlanta following his graduation from the University of Georgia in 1939 with a BS in commerce. He moved to Charlotte, North Carolina, where he was an agent and manager for Pilot Life until he became a Texan by moving to Houston in 1961. He joined American General in 1963 and has been a member of the company's Presidents Club five of the six years he has been eligible. A life and qualifying member of the Million Dollar

Round Table, he has been a participant in MDRT programs and is a sought-after speaker. As manager of the Business Planning Division of American General's Houston City Agency he engages in much joint work, which together with his individual production accounts for approximately \$1,000,000 in permanent life insurance premiums each year (yes, that says premium!). In addition to his industry activities, he is an active member of the Episcopal Church, the Masons, and other civic and service organizations.

that's where, because we can make more on that difference *each year* than your permanent insurance policy will provide." (Please note that he said "each year.")

I say, "Sir, how much *annual* net yield—net after all expenses and taxes—does your corporation earn on its capital?"

He says, "Fifteen per cent," or whatever the actual figure is.

I then ask, "How do you arrive at that figure?" to which he replies, "Well, we divide our capital into our annual net income after all expenses and taxes, and we arrive at the 15%-net-yield figure."

Then I say, "That's remarkable!"

"You're darned right it is," he says,

"and that's a heck of a lot more than your insurance company will give us, which is why our corporation bought the term insurance instead of that permanent insurance."

I respond with, "I congratulate you on your wisdom and on your idea of having your corporation purchase term and invest the difference in your corporation. Your corporation is doing well and will continue to do so with your keen business acumen."

Exchange the Term

"You've given my company a great idea on buying term and investing the difference, and in appreciation for that idea let me tell you what we're going to do for you. We have designed

a special policy called 'Executive 50,' and here it is, right here. I've been authorized by my company to let your corporation have it, provided you exchange that 'Super 100' decreasing term insurance policy for it."

He objects, "But we want and have paid for that decreasing term policy!"

I say, "Sir, this Executive 50 is also *super*, it's also for \$100,000, and it has decreasing term insurance built into it."

"You're age 30, so your 'Super 100' term insurance costs you \$300 a year. You said you wanted it, and your corporation bought it, and you said you were doing to keep it. But look, if your corporation will exchange that term policy for this Executive 50 and

CORPORATIONS SHOULD BUY TERM AND INVEST THE DIFFERENCE— IN PERMANENT

Male Age 30

SUPER 100 TERM INSURANCE

EXEC. 50 (*) PERMANENT INSURANCE *(ANNUAL PREMIUM—\$1,289.00)

Year	(1) Decreasing Term Insurance	(2) Term Ins. Premium	(3) Invest the Difference In Exec. 50	(4) Annual Increase in Assets	(5) Annual % Tax Free Profit	(6) Cumulative Available Asset	(7) Net Amount Death Proceeds (Decreasing Term Ins.)
1	\$100,000	\$300	\$989	\$ 840	-15.1	\$ 840	\$99,160
2	97,900	300	989	1,143	15.6	1,983	98,017
3	95,700	300	989	1,180	19.3	3,163	96,837
4	93,500	300	989	1,217	23.1	4,380	95,620
5	91,200	300	989	1,254	26.8	5,634	94,366
6	88,800	300	989	1,292	30.6	6,926	93,074
7	86,400	300	989	1,327	34.2	8,253	91,747
8	83,900	300	989	1,362	37.8	9,615	90,385
9	81,300	300	989	1,395	41.1	11,010	88,990
10	78,700	300	989	1,427	44.3	12,437	87,563
11	75,900	300	989	1,424	44.0	13,861	86,139
12	73,100	300	989	1,451	46.7	15,312	84,688
13	70,200	300	989	1,480	49.7	16,792	83,208
14	67,200	300	989	1,508	52.5	18,300	81,700
15	64,100	300	989	1,536	55.3	19,836	80,164
16	60,900	300	989	1,561	57.8	21,397	78,603
17	57,600	300	989	1,587	60.5	22,984	77,016
18	54,300	300	989	1,611	62.9	24,595	75,405
19	50,800	300	989	1,633	65.1	26,228	73,772
20	47,200	300	989	1,652	67.0	27,880	72,120
21	43,500	300	989	1,671	69.0	29,551	70,449
22	39,700	300	989	1,687	70.6	31,238	68,762
23	35,800	300	989	1,703	72.2	32,841	67,059
24	31,800	300	989	1,716	73.5	34,657	65,343
25	27,700	300	989	1,729	74.8	36,386	63,614
26	23,300	300	989	1,739	75.8	38,125	61,875
27	19,000	300	989	1,747	76.6	39,872	60,128
28	14,400	300	989	1,752	77.2	41,624	58,376
29	9,700	300	989	1,755	77.5	43,379	56,621
30	4,900	300	989	1,755	77.5	45,134	54,866

This is the illustration Mr. Harris uses to show the annual profitability of "investing the difference" in permanent insurance.

invest the difference—\$989 a year—with my company, we will guarantee to credit to your corporation account an average annual amount of \$1,505 for 30 years."

He says, "Man, how can you do that?"

My answer is, "Let me show you," and then I refer to the illustration of "corporations should buy term and invest the difference . . . in permanent," which is shown on page 25.

I then explain the illustration in this way:

"Column (1) shows your Super 100 decreasing term insurance. Compare that column with Column (7) for each year.

"Column (2) is your premium for the Super 100 decreasing term—\$300 each year.

"Column (3) is the \$989 annual difference between the premium for our Executive 50 at age 30 (\$1,289) and the \$300 annual premium for the decreasing term.

"Column (4) is the guaranteed annual increase in corporate assets attributable directly to that \$989 difference in premium, because your corporation will be paying the \$300 each year in either case.

"Column (5) is the corporation's annual percentage of tax-free gain on the \$989. Sir, your corporation will not and does not make that kind of annual percentage of tax-free gain on its own capital. To arrive at the percentages in Column (5), subtract Column (3) from Column (4) (except year one) and divide the \$989 into that difference. For example, in year five, Column (4) is \$1,254. Subtract the \$989 difference, which leaves \$265. Divide the \$265 by \$989, and the result is .268 or 26.8% return in that year on the \$989.

"Column (6) is the corporation's cumulative asset.

"Column (7) is the Executive 50's net amount of death proceeds (the decreasing term insurance built in). To arrive at those figures, subtract Column (6) from the face amount. Again for year five, the face amount is \$100,000, the cumulative asset in Column (6) is \$5,634, leaving net death proceeds of \$94,366 as reflected in Column (7).

"Now, I said earlier that we would guarantee to credit your corporation account with an average annual amount of \$1,505 for the deposit of that \$989 with my company each year. If you will divide the 30th-year cumulative asset figure in Column (6)—\$45,134—by 30 years, the result will

be \$1,505 average annual available cash for the corporation directly attributable to the \$989 difference invested in the permanent policy."

Annual Return

At the start of this article I indicated that I have been challenged on this illustration by a number of life underwriters, and invariably the challenge grows out of a misunderstanding of what it is I'm illustrating. *We are not talking about compound interest—we are talking about a corporation's annual return on its capital!* This concept is about corporations, not about personal investments. It has nothing to do with what individuals can do with their private funds placed in their investment programs. That's a different subject altogether. This is apparently where some people get lost—they attempt to relate the net annual yield on the \$989 "difference" to compound interest.

Corporate owners and those whose responsibility it is to make corporate annual reports to shareholders are concerned primarily with the year at hand—the one year for which they must account. They think in terms of an annual percentage return on their corporation's capital for that year, and they think in terms of one year at a time. Of course, they make plans for more than one year, but when they think in terms of the profitability of the corporation, it is always in terms of annual profitability.

I am not naive enough to think that large corporations don't have investment income as well as income from sales, or that they don't consider compound interest on those investments, because they do. However, smaller corporations and closely held corporations seldom have investment income, and therefore their executives are not concerned with compound interest.

But whether they have investment income or not is beside the point; this illustration simply has nothing to do with compound interest. It is an illustration of a corporate net annual return on a capital asset—the \$989 "difference," which the corporate head told me he was going to invest in the business.

Compare Profitability

It is important that this point be understood, because an accountant to whom this illustration is shown is likely to talk in terms of compound interest, and the life underwriter who

hopes to sell with it must be able to satisfy the accountant that no attempt is being made to compare this return with any form of long-term investment return; it is to be compared with the corporation's profitability, its return on its capital on an annual basis.

Well, back to the presentation:

After the corporate client analyzes all the columns for each year, he usually says, "Well, I'll be doggoned," and I say, "Me too!"

He agrees his corporation does not earn that kind of annual return on its capital, and I always point out again that for the \$989 each year (because we fixed in his mind that he would be paying the \$300 each year anyway) his corporation has available an average of \$1,505 a year.

This concept and the illustration will answer the constant, "Our corporation is going to buy term and invest the difference." The corporate client will buy term with little or no delay, because of the great difference in premium, so I sell him the term with no argument. But I order the permanent policy as an alternate, and I take both policies to the delivery interview. I explain the term policy carefully, and I fix in his mind that his corporation will be paying the term premium—that's the key to this sale. Then I show him the illustration and the permanent policy, and he will exchange the term for the permanent.

APPENDIX B

WHY SETTLE FOR ORDINARY "ORDINARY LIFE?"

Provident Ordinary Life isn't ordinary. Look at the rates, compare the cash values, study the net cost. Extra-ordinary? It certainly is!

WHOLE LIFE — MALES

AGE
34

ANNUAL PREMIUM
\$1,689

AMOUNT
\$100,000

Year	Annual Premium	Cash Value Increase	Cost for the Year	Cash Value	Paid Up Value
1	\$1,689	\$ 200	\$1,489.00	\$ 200	\$ 600
2	1,689	1,600	89.00	1,800	4,900
3	1,689	1,700	— 11.00	3,500	9,300
4	1,689	1,700	— 11.00	5,200	13,500
5	1,689	1,700	— 11.00	6,900	17,400
6	1,689	1,700	— 11.00	8,600	21,200
7	1,689	1,800	— 111.00	10,400	25,000

NOTICE
THIS THIRD YEAR
NET COST!

*That's . . .
"Life With Provident"*

Provident
LIFE AND ACCIDENT

CHATTANOOGA

Reprinted from Life Insurance Selling, Vol. 45, No. 4 (April, 1970), p. 42.

APPENDIX C

ILLUSTRATION PREPARED FOR
JOHN P CLIENT

PLAN HI VAL WHOLE LIFE
AGE 40
AMOUNT \$ 100000

PREMIUMS:
STANDARD 2448.00 Annual Special 208.28

Policy Year	Annual Dividend	Annual Net Payment	Cash Value Increase During Year	Annual Net Cost or Gain (%)	Cash Value End of Year	ALTERNATE DIVIDEND OPTIONS			
						Paid-Up Additions		Accumulation at Interest	1 Year Term for Following Year
						Insurance	Cash Value		
1	51.00	2397.00	1000	1397.00	1000	119	51	51	12911
2	37.00	2374.00	1900	437.00	2900	137	137	137	3580
3	17.00	2337.00	1900	437.00	4800	572	437	437	3000
4	152.00	2295.00	2000	295.00	6800	918	422	422	33333
5	187.00	2266.00	2000	266.00	8800	1330	627	632	33333
6	222.00	2226.00	2000	226.00	10800	1814	875	884	37000
7	257.00	2191.00	2000	191.00	12800	2365	1168	1183	39176
8	294.00	2154.00	2100	54.00	14900	2988	1509	1533	41004
9	329.00	2115.00	2000	119.00	16900	3677	1900	1935	41964
10	435.00	2013.00	2100	87.00*	19000	4564	2411	2462	50640
11	470.00	1978.00	2000	22.00*	21000	5514	2978	3049	50053
12	506.00	1945.00	2100	158.00*	23100	6528	3602	3700	49269
13	546.00	1897.00	2000	57.00*	25100	7417	5295	5417	48074
14	583.00	1835.00	2100	128.00*	27100	8337	6377	6603	45746
15	613.00	1798.00	2100	265.00*	29200	9335	5837	6063	45746
16	650.00	1763.00	2100	302.00*	31300	11196	6712	7001	44368
17	685.00	1726.00	2000	237.00*	33300	12516	7653	8018	42732
18	722.00	1691.00	2100	374.00*	35400	13898	8664	9121	41186
19	757.00	1655.00	2000	309.00*	37400	15339	9746	10311	39488
20	793.00	1655.00	2100	445.00*	39500	16840	10901	11594	37815
20 Avg.	422.05	2025.95		50.95					38828
360	793.00	1655.00	2100	445.00*	39500	16840	10901	11594	37815
365	968.00	1480.00	2000	520.00*	49500	25249	17816	19542	29575

MONTHLY INCOME—10 Years Certain and Life

Attained Age	Guaranteed Income	Special Life Income Option	
		Including Paid-Up Additions Cash Value	Including Accumulated Dividends
360	223.96	363.39	369.39
365	316.80	533.82	547.50

Dividends, interest, term insurance and special life options are based on the current scale and rates and are not a guarantee or estimate for the future.

POLICY MAY BECOME PAID UP:

In 27 years with Paid-Up Additions Option	
In 26 years with Accumulation Option	



Acacia Mutual Life

M 4 / 1 / 71 99 / 899

WHY DON'T YOU TRY THIS?

By HAROLD P. COOLEY

Objections and How to Answer Them

We were happy to have Allan Kent as our house guest a while back, and you may be sure that the life insurance business and its personnel got a good going-over. In recounting some past experiences with agents, I told him about a fellow who developed an intriguing way of disposing of "objections."

No matter which one of the routine objections the prospect came up with, the agent would counter with this: "Now, look, before we get into that, let me tell you something. I've been in this business long enough to know that there are a dozen 'objections' a man can come up with the minute I open my mouth about life insurance. I've not only encountered every one of them, but I've made a study of them to the point of having a real, honest answer to every one. I'm sure that both of us have too much to do to spend a lot of time sparring with each other. Do you mind if I get on with my business—for a few minutes?"

My friend used this method successfully enough to make a good living, and I have an idea that some of our readers might take a leaf out of his book.

Ordinarily, canned sales talks don't work in this business as well as in commodity selling, but I think you can "can" a carefully considered answer to any of the usual "objections" that are offered, after all, as a means of killing off the interview. I'm going to give you my idea of an answer to a few of these roadblocks that you encounter.

"I'm not interested in any more life insurance." Don't be too cute in handling this one. It's a little too "smarty" to ask, "What is it about life insurance you're not interested in?" That just encourages a smart retort. Try this: "I can understand your lack of interest in any more life insurance of the kind you know about. I suspect I've got a different kind in mind. Let me show it to you."

If you don't like that, try this: "I'm not surprised at your lack of interest in any more life insurance. It's a pretty damn dull subject and seems to be more concerned with death than life. The only part of life insurance you're likely to be interested in is *what it pays*—to you if you live and to your family if you don't, and that can be a helluva contrast to what you pay. There could be a lot you haven't discovered about that. I'd like to show you something. I probably should start by asking you, rather than telling you. You refer to more life insurance. Could I ask, 'more than what?'"

"I have all the life insurance I can afford." The answer to this statement can begin a good deal like the previous one—"you could easily have all the insurance you can afford of the kind you know about. What I want to show you could be quite different."

Remind him, in a kind way, that there are a number of things he *can't afford* but is currently paying for. He might trade some of them for things he *can't afford to be without*. He may be one of the great majority whose yearly outgo about equals his income,

and it's quite possible that he will have to buy the life insurance he needs with the money he spent last year for things he can do quite nicely without—the things he *really* can't afford. Only rarely does a man finance new life insurance from a raise in pay.

"I have a friend in the business."

My answer would probably be, "Good for him; he's in a good business. Would you mind telling me what company he represents?" If he prefers "not to say," you can make up your mind that the friend is either a myth or of no consequence—just a stall for the interview. Your chances aren't worth too much, so you have little to lose by asking him if he'll give you a chance to tell him just why you have called. You might call his attention to something his "friend" over-looked. If he insists that his friend has done a good job for him and that he wouldn't want to buy from any other agent, I'd move on to the next prospect.

"I can invest my money to better advantage than giving it to a life insurance company." Of course, there are two key questions you will ask—*what money* invested in *what*? You've got to ask the question in your gentlest manner. If you stir him up, he'll refuse to talk. If you know your man is in the middle-income class, you can be quite certain that he's not talking about investing capital but has probably been called on by a mutual fund salesman with growth ideas. If your opening question doesn't smoke him out, make it plain to him that it's quite impossible to draw fair comparisons between the contractual guarantees of the life insurance contract and the variable results of buying tiny pieces of some mammoth business that *promises* nothing. Tell him that what you're offering comes first and that an adequate life insurance program represents sort of a "spending or investing license" for the rest of his surplus income.

"Life insurance costs too much at my age." That's a natural assumption on your part, but let me show you something you never heard of." Open your rate manual and show him the figures that correspond with these that I've taken out of a stock life company book:

"You, at 45, can buy \$10,000 of ordinary life at an annual premium of \$275.80, but if you had bought it 15 years ago at age 30, the annual premium would have been \$160. However, by now, at the end of 15 years, \$4,250 of your \$10,000 would have become fully paid-up—so you would be

paying that \$160 annual premium for the \$5,750 unpaid balance. That figures out to be \$27.80 per thousand against the basic premium of \$27.58 at age 45. See what I mean?"

"I believe in buying term insurance and investing the difference."

"I'm not going to dispute that belief, because there's absolutely no basis for fair debate. You see, you don't know anyone who has actually *adequately* insured his life with term insurance and then *consistently and regularly* invested the difference between his annual premium and that of ordinary life. It's a most intriguing theory, but it just isn't being done. However, I'd like to show you something about term insurance that I'm sure you've never seen.

"Suppose a man 30 years old buys \$10,000 term to 65 for an annual premium of \$99.70. Incidentally, that's a lot cheaper than buying short-term policies and renewing at increasing premium rates. Let's suppose our man lives to 65 and pays his 35 annual premiums totalling \$3,490—with nothing for anyone at 65.

"On the other hand, he could have bought \$10,000 life paid-up at 65 for a gross annual premium—in a mutual company—of \$224.20, and in 10 years, using his dividends to reduce the premium, would have paid in a net total of \$1,845. At this point, if he still likes the term idea, he can elect the extended insurance provision in his contract and be guaranteed that his full \$10,000 of life insurance will continue in force for a term of 24 years and 157 days—with no further premium payments. When you add this 24 years and 157 days of insurance to the 10 years he paid \$1,845 for, it works out to be 34.43 years of \$10,000 insurance at an average of \$53.59 a year—about half the cost of term to 65."

At age 40, our friend is going to be older and, hopefully, smarter than at age 30, and he's likely to forget all about that brilliant "investment of the difference" and continue to pay his premiums and have his whole \$10,000 fully paid-up at 65 with a guaranteed cash value of \$7,399—along with a probable terminal dividend of \$199.

There's absolutely no evidence that points to his being able to equal that by "investing" any "difference" in anything.

Correspondence may be addressed to Harold P. Cooley at 40 Elm St., Kingston, Mass. 02360. **

Counters Buy Term Invest The Rest Argument At NALU Annual

By DILWORTH C. BRINTON

This is not an against talk. It is not against term insurance which I sell. It is not against variable annuities which I sell. It is not against mutual funds which I am licensed to sell. It is not against owning stocks, which I buy.

It is a for talk. It is for understanding whole life. It is for understanding the relationship of term insurance to whole life. It is for keeping old policies in force. It is for understanding how the rate of return increases as your policy grows older. It is for determining how to tell accurately what the "difference to invest" is. It is for understanding the built-in-hedge against inflation we have in participating whole life. It is for showing how term insurance plays into the hands of inflation. It is for showing why you should buy as much as you can as soon as you can.

Let's look again at the term-whole life picture. Many of us are guilty of supposing that just because we understand what we are talking about that our client understands also. We must be sure he understands whole life before we discuss differences.

I use a whole life ledger sheet with several important things I show every client. I want him to be so well informed he can answer the "twisters," because I won't be there when the "twister" calls. The columns in red are the most important columns on this summary because they show when you are getting more out of your policy than you are putting into it. It shows that you never risk more than \$2,800 when you buy \$100,000 protection

for your family at age 35. It shows you can get all your money back by the 13th year. This is because interest works for you in whole life.

Relationship Of Types

Now that we see some things whole life can do let's study the relationship of term and whole life.

Isn't it wonderful to know we can show this relationship for all ages on a single sheet. Here's what we learn about term insurance.

1. Very few people ever collect on term insurance because life expectancy is over age 70 for any person presently older than 15. Therefore term insurance is temporary insurance and temporary insurance should not be used for permanent Insurance needs, except in emergency situations.

2. Because of extremely low initial premiums very few people know how expensive term is over a long period of time.

3. Term insurance and inflation have exactly the same definition. Each and every year you pay a higher price for the same thing. People who are worried about inflation should not buy term insurance. Term insurance is "creeping inflation" to age 45 and "galloping inflation" thereafter. We will discuss this in detail when we discuss relationships.

4. We learn that for a healthy person, term can be lapsed and then reinstated without a financial penalty—indeed there is a gain—if you live. I have seen men under financial pressure drop term insurance because they can pick it up a few months later at the same price and save the premium in the meantime. This is another reason term insurance doesn't pay off. It often isn't

in force when it's needed.

Deciding whether to buy term or permanent insurance is somewhat like deciding whether to rent or buy a farm. If you need it for 30 or 40 years it is usually better to buy, (if you are a good farmer) as the value of the farm will increase as you care for it.

If you rent a farm or rent insurance for 40 years all you have is rent receipts. If you buy it, you own it. If you own it you can sell it. We will guarantee to buy it back if you don't want it. From 25 to 65 a \$100,000 whole life policy shows a net return over cost of \$30,923.00, add the \$34,614.00 cost of term insurance and the total difference is \$65,537.00. At age 35 term shows a cost of \$32,364.00 and whole life a net return of \$16,792.00. Total difference \$49,156.00.

Another interesting relationship is shown here. Term insurance goes up every year after you buy it. Whole life goes down every year after you buy it. (Current dividend scales not guaranteed.) The saddest man I can imagine is the man

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on the red line after it crosses the blue line. He is then paying more for term than his wiser neighbor is for whole life. The wise man is then in a position to buy whole life and invest the difference.

Inflation Hurt Term

We mentioned term insurance should be avoided by those who fear inflation—what should they buy? Whole life! Today's participating Whole life has a built in hedge against inflation because every year you pay a lower premium (with presumably cheaper dollars) for the same amount of protection! (An agent who sells primarily non-par usually has participating insurance in his portfolio for those who want it.)

Let's explore this hedge against inflation a little more, using age 25. The total whole life premium to age 65 is only \$29,277.00 for \$100,000.00 of protection. Even if all of that were paid at once—which it isn't, less than 30 cents on the dollar is being paid in. This means you still have a lot of room for inflation before the total dollars returned would have less purchasing power than the dollars paid in. There is another factor that's very important that can't be measured. Dollars received from insurance are almost always higher utility dollars than those paid in.

Another hedge is built into participating whole life. As interest earnings go up or mortality goes down, this too is reflected in participating whole life and the cost is reduced again.

Note Of Caution

A note of caution is that we do not use decreasing or disappearing term for our demonstration (showing "difference to invest") because the rate of decline in coverage is too rapid to permit its use.

The usual presentation of the "buy term, etc." group is to take the initial difference of whole life and decreasing term and compound it for the life of the policy or to age

65. This will not work if the calculations are made on a year to year basis.

This brings out a very important point of procedure. Do not deal in generalities—be sure everything is figured out on a basis that actually works. If you are checking a plan that has insurance and an equity product combined then separate it into its component parts.

Have you ever considered that the cost of money for a business is usually higher for term insurance than for whole life? When you buy whole life the cost of the money for the premium can never exceed 5% because you can borrow the cash value for that amount anytime you have a business opportunity or emergency. What is the cost of money for term insurance? What happens when you buy term insurance? It diminishes your cash and doesn't result in a corresponding increase in credit elsewhere.

If you are earning 10% on your assets then the cost of money used for term insurance is 10% because it would have earned that if you hadn't put it into term insurance. When you buy term insurance you reduce the net worth of your company thus reduce your borrowing power.

Increase In Value

On the other hand when your company buys whole life—particularly under the new ratable system of accounting you have a corresponding increase in value under other assets to offset the decrease in cash.

You may have noticed that the "invest the difference" group (who all have 20-20 hindsight) use 12% or even 15% as the annual growth rate for their investment.

My comment on this is that money is entitled to a wage but is not entitled to a profit.

If our client can borrow at 8% (or 5% if he owns cash value life insurance) then that is all money is worth. His net cost of borrowing

started a voluntary investment program in mutual funds were still in the program at the end of 10 years, 87% had failed.

Earnings Increase

The important thing to note is that every year you keep a whole life it becomes better. The rate of earnings increases. Should you cash in a two year old policy to "buy term, etc." the correct interest earning figure has now risen from 4.5% to 6% interest net after taxes.

Should you cash in a 10-year-old policy to "buy term and invest the difference?" I think this is where most of the controversy has arisen and I also think this is where many equity fund salesmen have made serious errors of fact in their presentations because they do not understand the wonderful things that have happened to a whole life policy by the time it is 10 years old.

It doesn't seem quite fair to me that the "twister" should be able to take the dollars we have so carefully saved and use them to work against us. The very fact that he has no other liquid assets than our life insurance cash values indicates the odds are against his successfully following an "invest the difference" plan.

Therefore, recognizing the fact that if he cashes in his policy he will have \$17,300 in cash to put into an investment plan, how do we proceed? If we cash in the insurance we have nothing left to compare with, so the solution I use is to keep the whole life insurance; let him borrow the loan value, put it into the market and charge the net interest against us. The net interest cost after the tax deduction is approximately 3% (40% income tax bracket and 5% insurance loan interest rate). Remember at this point that we are not discussing whether or not we should buy equities, we are concerned with whether to use our ten-year-old whole life policy or cash it in and "buy term and invest the difference."

There are additional plus features for the whole life plan. Here they are:

1. You can keep the whole life at

an increasingly lower premium or the term another five years at an increasingly higher premium.

2. You can repay the whole life loan from the investment fund and then use the policy for a retirement income based on today's guaranteed annuity rates.

3. You can repay the loan and have a paid up policy of approximately \$75,000 with no further premium payments.

4. You can repay the loan, keep the \$100,000 protection in force and let the dividends pay all or almost all the premiums.

5. You have had the safety and compulsion and automatic premium loan provision in the whole life over the 20 year period. You can't measure this in dollars but I feel it is extremely important.

Deferring Payment

How many of you have ever received a large insurance premium notice and said, "Oh no, not this month, how can I possibly pay it." But somehow you do and you keep

the protection. Can't you just hear yourself saying this under the other plan. "Boy, this term insurance is too high this month. Am I ever thankful I don't have whole life. I'll defer my investment payment till next month and try to catch up then." And that's the beginning of the end.

6. When you buy whole life, waiver of premium can be added which waives the whole life gross premium of \$2,294 rather than the lesser term premium.

7. When you buy whole life you can deduct the insurance premiums when figuring your net gain at age 65. Term insurance premiums cannot be deducted from your investment when you buy term and invest the difference. When planning your retirement would you rather be spending deductible or non-deductible dollars? I'll take whole life with its tax-free build-up as it grows and the deductibility of premiums from the annuity income.

Why Get Complicated?

by Raymond L. Paul, CLU

Rockford

If you view your role as a life insurance salesman as an opportunity to expose your prospect to your expertise as a logician, or if the object of your interviews is to display your technical knowledge, then read no farther. However, if you are looking for a concise yet simple explanation of the return on a life insurance contract versus the return on other investments, read on. I sold \$530,000 of Convertible Life in 25s, 30s, 50s and on up to \$125,000 in the first six months of this year, applying this idea.

When the issue of return enters the selling interviews, ask the prospect, "If you had a \$1,000 a year to invest in any investment, what kind of return do you think you would get on your money?"

ASSUME he answers 8 percent. "In other words, Mr. Prospect, for every \$1,000 you invested you would earn \$80 a year in interest. Isn't that right? Now, Mr. Prospect, if you were to invest that same \$1,000 in a life insurance contract, what kind of a return would you expect to get?" Most men normally say 4 percent. Regardless of what he says, I will not quibble over either of the percentage figures he chooses. "Therefore, Mr. Prospect, for every \$1,000 you invest in life insurance you will get \$40 a year in interest. What would it cost you to buy the life insurance? Wouldn't it cost you the difference between what you would have earned on your 8 percent investment and what you would earn on your life insurance investment? This amounts to \$40 a year. Would \$40 a year in additional earnings have any effect on your family's standard of living?"

Next, I explore what he gets for his \$40 a year. First, he gets a semi-compulsory savings plan which forces him to save regularly and consistently over

a long period of time. This is money he would normally fritter away. Two, he gets an absolutely safe investment; and, three, if he is around the age of 30 and invests \$1,000 a year in a Convertible Life contract, his family will get \$50,000 when he dies. "Mr. Prospect, that's \$50,000 worth of death protection for \$40 a year. Can you really afford to invest in anything else?"

AS A FOOTNOTE, the sophisticated prospect may say that I am overlooking the fact that we are using compound interest. My answer to him is that we also overlooked the income tax consequences of each method of investing. Also, how much would he actually have to invest each year after he has purchased \$50,000 worth of term insurance to protect his family?

After digesting this sales idea, I would hope that any knowledgeable Mass Mutual agent could poke holes in my logic. However, I have found that, for me at least, sophisticated Mass Mutual agents historically have been a very poor market. My prospects are just as rich but not as sophisticated.

Reprinted from The Radiator (Massachusetts Mutual Life Insurance Company), Vol. 57, No. 10 (November, 1969), p. 4.

APPENDIX G

*You get protection but no
cash value in term.*

"_____, you do have a lot of protection in that term policy for the \$_____ it costs. You know, of course, that there is no cash value in it. It's the kind of policy you have to die to beat.

*Permanent can give money back
if you don't die.*

"Did you know, _____, that the permanent kind of life insurance can be so arranged that you eventually get all of your money back if you don't die?"

(WAIT FOR ANSWER.)

*Since you get all your money
back, cost is interest on your
money.*

"Since you get all of your money back, the cost of permanent insurance is really just the interest on your money, isn't it?"

(WAIT FOR ANSWER.)

*Isn't term premium like interest
on permanent premium?*

"Now, here's an intriguing point. Since term premium pays just for the insurance, with no return, isn't that term premium just like interest on the permanent premium that buys the same amount of insurance?"

(WAIT FOR ANSWER. REPEAT IF NECESSARY.)

*You're paying about 30% interest.
Let me show you what I mean.*

"In that case, you are paying about 30% interest, _____

"Let me show you what I mean: At you age, _____, your \$_____ term policy costs you \$_____ per year. Whole life, which would return all of your money eventually, would cost you \$_____ a year for the same amount. The term premium is interest on the permanent. That's where I got the 30% interest figure. Don't you think that is pretty high? Can you invest money anywhere for that much return?"

(WAIT FOR ANSWER.)

"Well, you can make just such an investment here, by converting that term to permanent life insurance!"

Reprinted from Wayne W. Wolfe, *See You Next Week* (Indianapolis: The Research & Review Service of America, Inc., 1968), pp. 74-75.

STATEMENT OF THE COUNCIL OF HOUSING PRODUCERS

The members of the Council of Housing Producers appreciate the opportunity of presenting this statement in connection with the Committee's consideration of S. 984. The Council is made up of twelve of the nation's largest producers of housing.

In 1970, the members of the Council produced in excess of 55,000 units of residential construction. Many of the members are active in the Government's housing subsidy programs and provide housing for low and moderate income families, but the entire range of shelter needs for all income groups are served by the members. The members of the Council are dedicated to making available the maximum shelter for the consumer's purchasing dollar and to providing quality accommodations for all of the user groups being served. All of them are prepared to stand behind the homes they build and sell and every effort is made to remedy any construction deficiencies as promptly as possible after they are discovered.

There is no desire on the part of any member to avoid doing whatever is necessary to bring about correction of any unsatisfactory housing condition for which he is responsible. On the contrary, members often go far beyond their responsibility in satisfying complainants, recognizing that satisfied customers are the best possible form of advertising.

The Council is, however, concerned about the provisions of S. 984. Under the bill, there are sixteen items (Section 101, (1), (A) through (P)) which are defined as "unfair consumer practices." They deal with certain acts or practices in connection with selling or offering for sale "goods" and providing "services." The items relate to the manner in which the goods or services are offered as well as the representations made in reference to such offerings.

Under subsection 5 of the bill, "goods" is defined to include real property, but it specifically excludes securities, or interests in securities, or aircraft to the extent regulated in design or construction. Much of the same logic which apparently motivated the exclusion of securities and aircraft would seem to be equally applicable for the most part in the sale of homes and development sites. We assume securities are excluded since the registration and sale thereof is regulated by the Securities and Exchange Commission and the aircraft construction is regulated by prescribed standards and specifications. It is the Council's view that the same reasoning would warrant an exclusion for the sale of homes and building sites.

Homes and development sites have unique qualities which, for the most part, do not necessarily recur throughout the units being constructed or the sites being developed. Thus it would seem that several of the enumerated "unfair consumer practices" would have limited or no applicability to the purchase of residential real estate. They pertain more aptly to such items of personalty as appliances or other consumer products which are manufactured through the assembly line process which might have recurring defects. The inclusion of real property as "goods" would create much uncertainty as to what the real effect would be so far as residential property is concerned and could open the door to much unwarranted and frivolous litigation with consequent harmful results to the producer as well as added costs to the purchaser.

One of the principal problems with the proposed bill as it pertains to the coverage of real estate is the uncertainty which it creates. So far as the Council is aware, there has been no indication that abuses exist in the sale of residential property for which there is not an adequate remedy and which would be corrected by the legislation under consideration.

Litigation, whether warranted or unwarranted, is time-consuming and costly. If actions are instituted under the terms of legislation such as is here being considered, sellers will be obliged to take them into their calculations first in determining whether to proceed with a project and, if so, in the cost of doing business. Certainly nothing should be done to impede the construction of needed housing. In addition, construction costs have already far outstripped most other costs in the last two years rising about 14% annually. The house which cost \$25,000 in 1968 is now priced at \$29,500. Clearly every effort must be made to reduce this ever increasing price escalation rather than superimpose risks which add to costs and are passed on to the purchaser.

Furthermore, before a project is undertaken in most areas it is necessary to obtain the approval of the zoning authorities who make a thorough review to determine that what is proposed is suitable and compatible with what is in or planned for the area as well as in keeping with any community development plan which may be applicable. Construction must be approved by the building department and must be in conformity with the applicable building codes and restrictions.

But the actual regulation of the homebuilding and development industries goes far beyond local building code requirements and zoning restrictions. In the Housing and Urban Development Act of 1968, the Interstate Land Sales Full Disclosure Act became law. Thereunder, developers are prohibited from using any means or instruments of transportation or communication in interstate commerce, or the mails to sell or lease any lot in any subdivision covered by the statute, unless a statement of record is furnished the purchaser in advance of the signing of any contract, sales agreement or lease. Requirements with respect to what the statement must disclose are covered in the statute and regulations promulgated by the Secretary of Housing and Urban Development.

Subdivisions in which the lots being offered for sale or lease are located must be registered with the Secretary of HUD. The registration statement must contain the following information and be accompanied by the documents specified:

(1) the name and address of each person having an interest in the lots in the subdivision to be covered by the statement of record and the extent of such interest;

(2) a legal description of, and a statement of the total area included in, the subdivision and a statement of the topography thereof, together with a map showing the division proposed and the dimensions of the lots to be covered by the statement of record and their relation to existing streets and roads;

(3) a statement of the condition of the title to the land comprising the subdivision, including all encumbrances and deed restrictions and covenants applicable thereto;

(4) a statement of the general terms and conditions, including the range of selling prices of rents at which it is proposed to dispose of the lots in the subdivision;

(5) a statement of the present condition of access to the subdivision, the availability of sewage disposal facilities and other public utilities (including water, electricity, gas, and telephone facilities) in the subdivision, the proximity in miles of the subdivision to nearby municipalities, and the nature of any improvements to be installed by the developer and his estimated schedule for completion;

(6) in the case of any subdivision or portion thereof against which there exists a blanket encumbrance, a statement of the consequences for an individual purchaser of a failure, by the person or persons bound, to fulfill obligations under the instrument or instruments creating such encumbrance and the steps, if any, taken to protect the purchaser in such eventuality;

(7) (A) copy of its articles of incorporation, with all amendments thereto, if the developer is a corporation; (B) copies of all instruments by which the trust is created or declared, if the developer is a trust; (C) copies of its articles of partnership or association and all other papers pertaining to its organization, if the developer is a partnership, unincorporated association, joint stock company, or any other form of organization; and (D) if the purported holder of legal title is a person other than developer, copies of the above documents for such person;

(8) copies of the deed or other instrument establishing title to the subdivision in the developer or other person and copies of any instrument creating a lien or encumbrance upon the title of developer or other person or copies of the opinion or opinions of counsel in respect to the title to the subdivision in the developer or other person or copies of the title insurance policy guaranteeing such title;

(9) copies of all forms of conveyance to be used in selling or leasing lots to purchasers;

(10) copies of instruments creating easements or other restrictions; and

(11) such certified and uncertified financial statements of the developer as the Secretary may require.

There is provision for civil redress to any wronged party in case of a violation as well as express criminal penalties.

With respect to sales housing constructed and insured under the Federal Housing Administration programs, the purchaser receives a one year warranty that the dwelling was constructed in substantial conformity with the plans and specifications on which the Secretary of HUD based his valuation. The warranty requirement was imposed in the Housing Act of 1954. Furthermore, even though the warranty period has expired, if it is determined that there are construction deficiencies attributable to the builder, the Secretary may require correction under penalty of declining to permit the developer to do further business with the Department unless satisfactory corrections are made. If the developer fails to correct structural defects, the Secretary is authorized to make expenditures for correcting the defects or paying the claims of the owner arising therefrom. Such relief may be requested by the owner at any time within four years from the date the property was acquired. (Section 518. Added by the Housing Act of 1964—P.L. 88-560).

Similarly, in the case of homes purchased by veterans with loans guaranteed by the Veterans Administration, the builder's warranty provision is applicable (Title 38, Section 1805 U.S.C.A.). If the defects are not corrected, the VA Administrator has authority to make expenditures for correction or reimbursing the owner. (Title 38, Section 1827 U.S.C.A.)

Thus in respect to lots covered by the Interstate Land Sales Full Disclosure Act and homes purchased with the FHA insured and VA guaranteed loans, the reasoning which prompted the exemption of securities and aircraft construction would be equally applicable. In addition, it would appear to follow that as to homes conventionally financed, if the builder were to give the purchaser a warranty similar to that required by FHA and VA the objective would be achieved.

The Council is not aware of any recurring situations in which home or site purchasers would have been afforded a remedy under legislation now being considered which would have improved their positions beyond the remedies presently existing. Unless a clear need is demonstrated, and this does not appear to be the case, it would seem that there are inherent dangers in enacting such wide sweeping legislation as that here proposed. Thus, there is the basic question of whether the sale of homes and building sites ought to be included at all.

But if it should be concluded that a need exists for providing a remedy along the lines proposed in S. 984, the Council respectfully suggests that as to those units of residential property which are subject to FHA or VA requirements, or on which a comparable warranty is given by the builder, and development lots registered under the Interstate Land Sales Full Disclosure Act, there be an exemption provided since the purchasers are afforded with a remedy which generally is more effective and more suitable than the one proposed in the bill.

STATEMENT OF AMERICAN LIFE CONVENTION, HEALTH INSURANCE ASSOCIATION OF AMERICA, AND LIFE INSURANCE ASSOCIATION OF AMERICA

The American Life Convention, the Health Insurance Association of America, and the Life Insurance Association of America are three organizations of life insurance companies, health insurance companies, and life and health insurance companies having a combined membership of 485 United States and Canadian companies, accounting for about 92 percent of the total life insurance in force in the United States and about 90 percent of the health insurance. Our comments with respect to S. 984, S. 1222, and S. 1378 follow.

S. 984

While our statement is directed to all of the bills scheduled for consideration by the Subcommittee, our associations are concerned primarily with S. 984, the proposed "Consumer Class Action Act of 1971". This bill would make unlawful fifteen specified "unfair consumer practices" principally related to the offering or advertising of "goods or services", and "any other act or practice which is unfair or deceptive to a consumer and is prohibited by section 5(a)(1) of the Federal Trade Commission Act." Section 101(6) of S. 984 defines the term "services" to include "insurance services". Alleged violators would be subject

to cease-and-desist proceedings by the Federal Trade Commission, and, if successful, these proceedings could be followed by civil class action suits by consumers. In addition, under other provisions of the bill, if a consumer has paid an amount greater than \$10 in any transaction as a result of such an "unfair consumer practice", he could bring a class action suit on behalf of others without awaiting prior governmental action, provided that he has given the FTC 90 days' notice of the alleged violation.

Our associations' objection to this bill is that the inclusion of "insurance services" in section 101(6) is clearly inconsistent with the McCarran-Ferguson Act (15 U.S.C. 1011-1015).

For well over 100 years the insurance business has been regulated by the states, not the federal government. Prior to 1944, insurance was considered not to be commerce. Thus the federal government was without power to regulate insurance, and the states had full regulatory authority unrestricted by the commerce clause. In *United States v. South-Eastern Underwriters Assn.*, 322 U.S. 533 (1944), the Supreme Court for the first time held that insurance is commerce.

Nine months later, Congress enacted the McCarran-Ferguson Act. Section 1 of that Act declares that "the continued regulation and taxation by the several States of the business of insurance is in the public interest. . . ." Section 2(a) provides that "the business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business." Section 3(a) established a three-year moratorium period during which the Sherman Act, the Clayton Act, and the Federal Trade Commission Act "shall not apply to the business of insurance or to acts in the conduct thereof." Section 2(b) states that after the three-year moratorium these federal Acts, as amended, "shall be applicable to the business of insurance to the extent that such business is not regulated by State law."

The purpose of sections 1 and 2(a) was to declare that the states (not the federal government) should continue to have the responsibility for the regulation of the insurance business, and to remove the commerce clause as any possible obstacle to such state regulation. More specifically related to the present issue, the purpose of sections 3(a) and 2(b) was to give the states three years in which to enact legislation covering the areas of the Sherman Act, the Clayton Act, and the Federal Trade Commission Act. This was an invitation by Congress to the states to adopt regulation in these areas, with the express declaration that thereafter those three federal statutes would not apply to the extent that the states had adopted such regulation.

All of the states have accepted this invitation. Each state now includes as a part of its insurance code the Model State Fair Trade Practices Act, which is patterned after the Federal Trade Commission Act, and contains the same broad proscriptions against all "unfair methods of competition of unfair or deceptive acts or practices". The Supreme Court of the United States has expressly held that the existence of these state laws makes section 5 of the Federal Trade Commission Act inapplicable to insurance. *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560 (1958).

It is thus apparent that the reference to "insurance services" in section 101(6) of S. 984 makes the bill inconsistent with this previous action of Congress, and with the action taken by all of the states in pursuance of this earlier Congressional invitation. By virtue of the express reference to "insurance services" the bill would permit actions against insurance companies by the Federal Trade Commission with respect to the various categories of "unfair consumer practices" proposed under section 101. Clearly the Model State Fair Trade Practices Acts cover all of these areas, and many more. To that extent, therefore, there would be a partial repeal of the McCarran-Ferguson Act. No reason has been given or indicated for this proposed reversal of Congressional position.

Not only is section 101(6) of S. 984 inconsistent with the McCarran-Ferguson Act, but, as a practical matter it would inevitably lead to great confusion. If the bill were enacted in its present form, presumably both the state model laws and the new federal law would apply to the same specified practices. Thus, there would be duplicative state and federal procedures. Moreover, in dealing with concepts as broad as those here involved, it would seem inevitable that disagreements between state and federal authorities would occur.

We note that section 101(6) of the bill specifically excludes from the definition of "services" credit or the adequacy of service of common carriers to the extent

regulated, presumably because they are regulated by other federal statutes. We think there is even stronger reason for excluding "insurance services" from section 101(6). Not only does every state regulate in the areas contemplated under S. 984, but this regulation has been adopted at the express suggestion of Congress.

S. 1222

A second class action proposal before the Subcommittee—S. 1222, the proposed "Consumer Fraud Prevention Act of 1971"—recognizes these important considerations, and expressly excludes "insurance services" from the definition of "services". More specifically, section 2(f) of S. 1222 provides that the term "services" includes the provision of intangibles "... other than (i) insurance services; [and] (ii) credit services and services by common carriers and public utilities, to the extent that unfair consumer practices are prohibited with respect to these services under other Federal law or regulations". This provision is consistent with the position of our associations stated above, and we urge its inclusion if the Subcommittee takes action on S. 1222. We also urge that the definition of "services" provided in section 2(f) of S. 1222 be included in lieu of section 101(6) of S. 984 if favorable action is recommended on the latter bill.

S. 1378

A third proposal before the Subcommittee—S. 1378—also includes "insurance services" in the definition of "services" (section 3(e)), in a manner somewhat similar to S. 984. The overall approach of this bill, however, is somewhat different from that embodied in S. 984. This bill would create a federal cause of action for violation of any one of a number of specified "unfair consumer practices" as well as for violation of state statutory or decisional law for the benefit of consumers. It would authorize direct consumer class actions—without any prior governmental action—in either the federal or the state courts for any such violation. The "unfair consumer practices" specified in S. 1378 are all practices which are now subject to the Model State Fair Trade Practices Acts in the insurance field.

Thus, there is a clear possibility that the federal courts might construe these federal prohibitions in a manner inconsistent with the construction placed upon existing state laws covering the same practices. This could lead to serious conflicts between federal and state law dealing with the same subject matter, thereby causing substantial confusion and interference with the enforcement of state law by state officials. As the Supreme Court stated in *Garner v. Teamsters, Chauffeurs and Helpers, etc.*, 346 U.S. 485, 490-491 (1953): "A multiplicity of tribunals and a diversity of procedures are quite as apt to produce incompatible or conflicting adjudications as are different rules of substantive law."

The inclusion of "insurance services" in S. 1378 therefore also conflicts with the rationale of the McCarran Act. Accordingly, we recommend that, if favorable action is taken on S. 1378, the definition in section 3(e) be amended to make it clear that the term "services" does not include insurance.

SUMMARY

For the reasons stated above, we do not believe the term "services" should include insurance. S. 1222, section 2(f), specifically provides that the term "services" includes the provisions of intangibles "... other than (i) insurance services; . . ." [underlining added]. We support this definition of "services" in S. 1222. Moreover, we urge that this same definition be included in S. 984 or S. 1378 if the Subcommittee should approve either of these bills.

We would welcome the opportunity to discuss our views on these bills further with the Subcommittee or its staff.

STATEMENT OF AMERICAN FROZEN FOOD INSTITUTE

The undersigned Thomas B. Houe presents the following statement on behalf of the American Frozen Food Institute whose members pack approximately 85 percent of the national production of frozen foods. S. 984 would provide for suits by individual consumers against suppliers found by the Federal Trade

Commission to be guilty of "unfair consumer practices" as defined in the bill. In addition, S. 984 provides for class actions on behalf of consumers where the Federal Trade Commission has failed to act against suppliers committing unfair consumer practices.

The Institute does, of course, support appropriate legislation prohibiting deceptive and fraudulent practices where they exist. We have not, however, seen any evidence that the unfair consumer practices listed in S. 984 exist in the frozen food industry. Moreover, no evidence has been forthcoming to show that current Federal and state legislation is not adequate to prevent such practices in the industry, were they to exist. For these reasons and those set forth below, the Institute opposes application of S. 984 to the frozen food industry.

Part I of this statement will acquaint this committee with the historical development of the frozen food industry and with current industry-consumer relationships. Part II will show the adequacy of present Federal and state laws and regulations applicable to the food industry.

PART I

A. History of the Frozen Food Industry

Clarence Birdseye's theory of "quick freezing" evolved from his observation of fish and other foods which froze almost instantly upon exposure to arctic air. When thawed and cooked, the food retained the characteristics of its fresh form. In 1929, what is now General Foods Corporation, acquired Clarence Birdseye's equipment and patents, giving the frozen food industry its first great impetus. From that point onward, new processes, equipment, and refrigerants came into being.

It soon became evident that varieties of fruits and vegetables suitable for canning and for the fresh market were not necessarily the best for freezing. Trial and error was quickly replaced by scientific research to develop varieties ideally suited to preservation by freezing. Close working arrangements developed between packers and growers to establish horticultural procedures and controls to insure harvesting and processing of product at the peak of freshness and quality. At the same time, the frozen food industry opened new markets for agricultural products.

A classic example may be seen in the case of frozen potato products during the period 1956-1969 when per capita consumption of all forms of potatoes increased from 103 to 118 pounds. During the same period, per capita consumption of frozen potato products rose from 3 to nearly 25 pounds. Freezing removes some of the seasonal aspects from potato marketing and makes possible utilization of some types and sizes of potatoes which otherwise would be discarded.

At the outset, experiments and failures in the development of frozen food packaging materials were common. Again, laboratory research came to the rescue and established the characteristics essential for adequate frozen food containers. The frozen food industry provided a new and expanding market for packaging materials of all kinds. Now a large segment of the American packaging industry serves the frozen food industry to package its 14 billion plus pounds of product annually.

Science research established that 0° F was the optimum maximum temperature for storing and handling frozen foods to insure retention of their inherently high quality, flavor and nutrition. The old "ice and salt" railroad cars were incapable of maintaining this temperature. At the frozen food industry's urging, the modern, mechanically refrigerated car was developed which easily meets this requirement under any conditions. Within less than a quarter of a century, the fleet of this equipment has grown from zero to nearly 25,000 cars.

A similar investment has been made by the motor carrier industry in the application of mechanical refrigeration to the refrigerated truck fleet to insure adequate equipment for correct handling of frozen foods. In like manner, refrigerated warehouses, which were at one time hard pressed to maintain product at 0° F to 10° F, can in many instances guarantee storage at minus 10° F. In the beginning, frozen foods represented only a minor portion of refrigerated warehouse business; now they account for approximately 75% of total refrigerated warehouse space.

The mass of American consumers had frozen foods brought to their attention during World War II by virtue of the fact that their non-critical packaging

required the surrender of fewer ration points than did canned food. However, consumer acceptance was good, and during the post-war years an increasing number of firms came to realize the true potential of the frozen food market and began to promote it. By the late 1940's, the large supermarket chains recognized that they must carry frozen foods to satisfy consumer demand.

Retail display equipment was constantly improved and stores which averaged 55 lineal feet of frozen food cabinet space in 1954 increased that to 90 feet in 1957 and have as much as 200 lineal feet today. A corresponding increase in frozen food storage took place in the consumer's home. The ice cube section of the refrigerator gave way to separate freezer compartments capable of holding at 0° F a week's supply of frozen food for a large family.

About this time, foodservice operators became aware of the many advantages of frozen convenience foods in their establishments. They were attracted not only by the high quality of frozen food, but the saving of time and labor in their kitchens added significantly to their profits. It is currently estimated that 40% of all frozen food sold in the United States enters the institutional market.

Frozen food production has shown a steady and continuing growth from 648 million pounds in 1942 to more than 14 billion pounds in 1970, with a retail value approaching seven billion dollars. Fish was one of the earliest products to be frozen and was quickly followed by fruits and berries, vegetables, and a host of pre-cooked and prepared items. New products from entrees to complete meals and new packaging innovation such as the boilable pouch are daily gaining consumer acceptance. More than 60% of the Florida orange crop is marketed in the form of frozen concentrated orange juice.

It is these developments which have combined to shape the growth of the American frozen food industry from infancy to its present giant stature. There is no better method of food preservation known than freezing. Industry and government research has established the high nutritional value of frozen food. The products of our industry enjoy an enviable and unequaled public health record. The consumer is reaping the benefits afforded by the frozen food industry in the form of an almost limitless variety of appealing, flavorful, nutritious, and wholesome food, available economically, every day in the year.

Adherence to the 0° F handling requirement is essential to maintaining these superior qualities of frozen food. A few years ago, the Association of Food and Drug Officials of the United States promulgated a model frozen food handling code which has been adopted as law in nine states and is used in others as an administrative guide in enforcement of existing pure food laws. The Institute commends these efforts in the public interest. Additionally, the industry itself has developed a voluntary code of recommended handling practices which is even more specific and which has been subscribed to by eleven major national trade organizations having a significant interest in frozen food.

The Food and Drug Administration has issued umbrella regulations in the form of Good Manufacturing Practices for the food processing industry. The Institute not only wholeheartedly supports these regulations but is working cooperatively with the FDA in the development of quality assurance programs which even go beyond the scope of the GMP's in furtherance of the industry's desire to insure optimum quality and value of its products in consonance with the public interest.

B. Industry-Consumer Relationships

The shopper in today's supermarket is exposed to a wide variety of competitive frozen food products. If the consumer's expectations concerning a particular product are not met, the consumer will not repeat her mistake but will choose a competing brand. It is, therefore, obviously in the interest of manufacturers to insure that their products meet consumer expectations, and most of the time those expectations are met. On those infrequent occasions, however, when the consumer is not satisfied with a product, it is the policy of the vast majority of the companies which offer frozen foods to the retail trade to either refund to the customer the value of the merchandise or replace the product.

PART II. ADEQUACY OF PRESENT AND STATE LAWS AND REGULATIONS

The "unfair consumer practices" listed in S. 984 would today, in the case of their commission by frozen food suppliers, form the basis for legal action against the offenders under one or more of the following laws: the Federal Trade Com-

mission Act; the Federal Food, Drug and Cosmetic Act; the Fair Packaging and Labeling Act; and kindred state and local statutes in effect in most jurisdictions. The Food, Drug and Cosmetic Act and the Fair Packaging and Labeling Act provide the Food and Drug Administration with ample legal means to protect consumers against fraud and deceit in food labeling and composition. Under these laws the government has a broad array of legal sanction, *viz.*, seizure of violative products, injunction actions against sellers, and criminal prosecution of offenders.

Sections 12 and 13 of the Federal Trade Commission Act, empower the Federal Trade Commission to prohibit false advertisement of foods in commerce by suit for injunctive relief. In addition, the Attorney General is authorized to criminally prosecute violations of the false advertising provision (Section 12), with fines up to \$10,000 or imprisonment up to one year or both.

The several states of the Union have enacted legislation similar to the Federal legislation just reviewed. In addition, we are informed that at least twelve states have enacted legislation adopting a uniform deceptive trade practices act, which provides for injunctive proceedings against unfair consumer practices similar to those listed in Section 101 of S. 984.

In light of the comprehensive Federal regulation against fraud and deception in the marketing of foods, and the counterpart state legislation and the widespread policy of the industry to either refund the purchase price to dissatisfied consumers or replace the product, the Institute sees no rational basis for application of S. 984 to the frozen food industry.

Respectfully submitted.

THOMAS B. HOUSE, *President.*

STATEMENT OF THE SOUTHERN STATES INDUSTRIAL COUNCIL

Last year both this Subcommittee and the Senate Judiciary Committee heard many hours of testimony and collected thousands of words in statements from well qualified persons on proposed class action legislation. From this mass of evidence it was made clear that the proposed legislation was so filled with imperfections and deficiencies that it was completely unworkable and would not, in fact, give consumers real protection from fraud, but would subject honest businessmen to great harassment and unjustified expense.

The proponents of class actions have had a year to come up with legislation which would correct the deficiencies that were so thoroughly exposed in the hearings on class actions during the 91st Congress. They have not done so, and the bills before the Subcommittee still contain almost all the old discredited provisions. This should be sufficient proof that the whole concept behind the legislation is faulty. In short, the advocates of broad authorization for consumer class action suits have not been able to make their case that this is a workable and effective consumer remedy for fraudulent and deceptive practices. It is time that the friends of consumers in the Congress turn their backs on the class action concept and look for better ways to prevent unscrupulous operators from preying upon the public.

Class action suits violate traditional rules of justice and fair play. Not only can they cause tremendous difficulty and expense to companies which have built their business on ethical dealing and integrity but which may at some time inadvertently put out a faulty product; they do not get to the real culprit—the fly-by-night operator with a deliberate intent to defraud.

The promise held forth by proponents of a quick and easy means of “getting your money back” through class actions is itself a fraud upon the consumer. The class action method of recovery is exceedingly slow, unwieldy and inefficient. Many Federal court dockets are years behind. Just the determination of what persons constitute the class in the action usually requires from several months to several years before the trial can get under way and the trial itself may last for several years more including appeals etc.

Consumer class actions already are permitted in the Federal courts with certain safeguards under Rule 23. The proposed bills, however, would encourage lawyers to promote class action suits and engage in questionable practices in the solicitation of plaintiffs. It is more than likely that suits would be based more on the size of the defendant company and its ability to pay huge money judgements

than on the seriousness of the offense. The pending legislation would virtually invite harrasing and strike suits because of the possibility of awards of big attorney fees and court costs. All the risk and the expense burden falls upon the defendant company. The attorney who is unsuccessful in a strike suit can simply shrug his shoulders and walk away. Furthermore, many of today's young lawyers, imbued with zeal to perform social service, would be prompted to instigate unwarranted class action suits out of a desire to effect what they believe to be reforms needed by society.

The burden which the proposed class action legislation would place on the Federal courts would be tremendous. The volume of such suits could bog down completely the already much overloaded courts. Furthermore, class action suits would saddle Federal judges with the burden of determining for each individual involved in a class action the degree of damages, if any, and the form and amount of restitution that would be proper since each plaintiff is not necessarily damaged to the same degree. When it is considered that the number of consumers involved in a class action could run up to 1,000,000 or more, the unmanageability and absurdity of the whole thing becomes apparent. This by itself, without the many other unfair and unworkable features of the legislation, is sufficient cause for its rejection.

One of the bills under consideration—S. 1378—contains what has been commonly referred to as a "laundry list" of 19 unfair consumer practices as bases for class action, with an open ended provision that would permit the Federal Trade Commission to add to the list. This provision, taken in conjunction with the supremacy clause of Federal over state law, would mean that in effect the FTC could repeal state laws on fraud. The idea of giving a Federal regulatory agency veto power over state law is just another of the absurdities that appear in the class action legislation.

Under the common law, a civil fraud action must be substantiated by proving each of several distinct elements—misrepresentation, reliance by plaintiff on the misrepresentation, and thirdly, damage to the plaintiff. The plaintiff has the burden of proving all three elements. In the application of Section 5 of the Federal Trade Commission act, however, neither the Commission nor the courts have observed this strict burden of proof requirement. All the Commission has been required to determine, with respect to advertising for instance, is whether there is a "tendency to deceive". Reliance by a given plaintiff and damage to him need not be proved. When this liberalized burden of proof is applied to the "laundry list" of unfair consumer practices, it is apparent that much of the protection of the common law will be denied the defendant and he will be put in the position of rebutting a presumption, rather than defending a case in which the plaintiff carries the burden of proof.

An equally serious flaw in consumer class action suits is that they impinge on a fundamental right of due process—the right to confront and examine each and every plaintiff or accuser. The defendant hears the testimony of only one, or a few, witnesses whom he can cross-examine in court. He is denied the opportunity to question absent members of the class who are deemed to have relied on the alleged misrepresentation. Clearly, reliance involves many substantive considerations which can only be established by direct questioning of the person whom, it is claimed, has been damaged by such reliance. Thus the class action theory, as applied in many class action suits based upon fraudulent representation, raises a serious constitutional question of denial of substantive due process.

It is extremely unfair to require that a defendant business firm be required to pay the costs of legal defense against class action suits even when successful in disproving the charges. A much fairer procedure would allow the prevailing party in a class action to recover costs of the suit, including both attorney fees and court costs. To insure payment of these costs, plaintiffs should be required to post bond at the time of filing of the suits. Those filing suits would think twice if they knew that if they were unsuccessful, they would automatically be liable for all the costs of the litigation.

Another of the deficiencies in proposed class action legislation is that all consumers supposedly suffering loss from an allegedly fraudulent practice are entitled to receive restitution in a successful class action suit unless they have opted out. The reverse should be the case. Consumers should be required to make a positive statement they want to be plaintiffs in order to be included, should be

informed of their liability for payment of costs of the suit if they are losers, and should be required to participate in the posting of bond to cover costs.

Members of the Southern States Industrial Council do not condone deceptive or fraudulent practices by any business firm. All business is harmed when consumers are deceived and defrauded by dishonorable businessmen. But encouraging and promoting consumer class actions that are unjust, unworkable, costly and time-consuming is not the answer to the problem of fraud. The approach that is best for both the consumer and the businessman is to take any steps that may be necessary to prevent fraud before it occurs.

Consumer class action suits already are permitted in state courts and under Rule 23 in Federal court under carefully drawn safeguards. Removing those safeguards and throwing open the Federal courts to virtually any and all class action suits would be a grave mistake, and the Southern States Industrial Council urges this Subcommittee to recommend against the enactment of any class action legislation at this time.

STATEMENT BY T. LAWRENCE JONES, PRESIDENT, AMERICAN INSURANCE ASSOCIATION

American Insurance Association is an organization of insurance companies writing all forms of property and casualty insurance. The annual premium volume of its member companies is in excess of \$7 billion.

We are concerned about S. 984 and related measures which have been under review by the Subcommittee for Consumers of the Senate Commerce Committee. Section 101(1) sets out 15 defined unfair or deceptive practices: Included in this "laundry list" of unfair consumer practices is one which reads "advertising goods and services intending not to supply reasonable expectable public demand, unless the advertisement discloses a limitation." Section 101(6) defines "services" to include "insurance services."

Violations of any of these unfair consumer practices would subject the violator to cease-and-desist proceedings by the Federal Trade Commission. If these proceedings were successful, the violator would then be subject to suit by any consumer "adversely affected by the act", provided that his individual damage was greater than \$10. Section 102(b)(1) allows an injured consumer to bring a class action suit under Rule 23 of the Federal Rules of Civil Procedure.

We find it difficult to understand the inclusion of "insurance services" in Section 101(6) in light of its obvious inconsistency with the McCarran-Ferguson Act (15 U.S.C. 1011-1015).

The McCarran-Ferguson Act was adopted in 1945 in response to the Supreme Court's decision in *United States vs. South Eastern Underwriters Association*, 322 U.S. 533 (1944). The court stated in its opinion that insurance was commerce and thus subject to the federal anti-trust laws. The failure of Congress to act in regulating the insurance industry was not viewed by the court as intent not to regulate. McCarran-Ferguson was an explicit statement of Congressional intent leaving the regulation to the several states as the method most in the public interest. This law also provided that federal anti-trust laws, including the Federal Trade Commission Act, would not apply "to the business of insurance to the extent regulated by state law," except for boycott, coercion and intimidation.

McCarran-Ferguson was a great challenge to the states and they promptly responded. Rate regulatory laws were passed to avoid the provision of the Sherman Anti-trust Act and a model state Fair Trade Practice Law patterned after the Federal Trade Commission Act and recommended by the National Association of Insurance Commissioners was enacted to correspond to the Federal Trade Commission Act. All of the states have enacted these laws.

All of the state Fair Trade Practices Laws encompass the specified unfair and deceptive practices set forth in S. 984. The business of insurance has an available and working mechanism at the state level for dealing with any such practices, which is not the case with most of the providers of goods and services which this bill is designed to cover.

S. 984 would have the effect of partially dismantling the McCarran-Ferguson Act, which was a carefully drafted law that has worked exceedingly well. States continue to regulate the business of insurance and certain federal laws apply only in the absence of state regulation. An ad hoc approach to the dismantling of the McCarran-Ferguson Act is not consistent with the wisdom Congress has

shown in the past in refraining from erecting another competing layer of regulation applicable to the insurance business when there has been no showing of ineffective performance by the state regulatory mechanisms.

We note that the Administration bill, S. 1222, has no mention of insurance, which is a difference from a similar measure they sponsored in the last session of Congress. When questioned on April 27, 1971, by Chairman Moss as to the reasons for this change, Assistant Attorney-General Richard W. McLaren replied that the Justice Department has re-evaluated the performance of the state regulatory bodies and found that the states had done an ample job in this area.

Similarly, we note the testimony of Mr. John A. Durkin, Insurance Commissioner of the State of New Hampshire. His statement on this matter is one to which we wholeheartedly subscribe.

We agree with Mr. Durkin and Mr. McLaren that it would be most unsound to make this major change in the McCarran-Ferguson concept. We therefore urge that Section 101(6) be amended to read:

"Services includes provision of intangibles, but not the providing of credit to the extent that credit is regulated under the Truth in Lending Act (15 U.S.C. 1601 et. seq.), or the adequacy of service of common carriers to the extent regulated; and . . ."

In our judgment, the reasons for this amendment should be set forth in the report which accompanies this bill in order to make it clear that this legislation is not intended to have application to the business of insurance.

Respectfully submitted.

STATEMENT OF NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

The National Association of Mutual Insurance Companies is a trade association comprised of more than one thousand mutual fire and casualty insurance companies. Its headquarters is located in Indianapolis, Indiana.

This Association is opposed to the inclusion of "insurance services" in the legislation before the Subcommittee for which class actions may be brought for unfair consumer practices. Unfair consumer practices are not to be condoned under any circumstances, and the National Association of Mutual Insurance Companies supports any effort to prevent such practices. There are compelling reasons for excluding "insurance services" from the legislation, and we list the following reasons in general terms for your information:

1. The insurance laws of the several states provide effective protection for the consuming public. Insurance companies and agents are regulated stringently in their relations with the public and in their conduct of the insurance business.

2. State Unfair Trade Practices Acts exist in every state. Unfair methods of competition or unfair or deceptive acts in the insurance business are prohibited under such Acts.

3. Insurance departments of the several states effectively service complaints related to insurance by the public and have provided protection against unfair or fraudulent practices. Such protection and assistance is provided more speedily and with less cost than the complex, slow-moving class action approach.

4. Costly confusion and conflicts could result from a dual system of federal-state law should "insurance services" be included in a federal law.

5. It is believed that over-exuberant lawyers will promote spurious class actions which will harass ethical and honest businessmen while allowing unethical operators to escape prosecution due to their hit-and-run methods of operation. The costs of these actions inevitably will be passed on to the consuming public who will pay in the form of higher prices for products and services.

6. Class actions in the insurance area would lead to a heavier caseload in the Federal Court System at a time when an overall effort is being made by the Federal Judiciary to reduce the overloaded courts.

In conclusion, this Association concurs with the position of the National Association of Insurance Commissioners on the legislation before the Subcommittee. We commend its enlightened, detailed, and well-reasoned document in revealing the necessity for exclusion of "insurance services" from the legislation. The National Association of Mutual Insurance Companies submits that there is no

need for the "insurance services" provision, and it is respectfully requested that it be stricken from the legislation. The privilege of submitting these views is appreciated greatly.

THE AMERICAN BANKERS ASSOCIATION,
Washington, D.C., April 30, 1971.

HON. FRANK MOSS,
Chairman, Subcommittee for Consumers, Committee on Commerce, Senate Office Building, Washington, D.C.

Dear SENATOR MOSS: The American Bankers Association appreciates this opportunity to present its views on S. 984, S. 1222, and S. 1378, the class action legislation pending before this Subcommittee.

All three of these bills are intended to protect the consumer against unfair and deceptive practices in connection with the purchase of goods and services. However, because of the broad authority given to the Federal Trade Commission, and indefinite nature of the definitions, we feel that banks could come under the jurisdiction of the Commission, and thus become the subject of class action suits.

The Congress has made it clear, ever since the establishment of the Federal Trade Commission in 1914, that banks have been exempt from the Commission's jurisdiction. We think this exemption should continue for a number of reasons. First, banks are already subject to continuous and exhaustive supervision and examination by State and Federal bank regulatory authorities. These authorities are given broad power under State law, the National Bank Act, the Federal Reserve Act, the Federal Deposit Insurance Act, and the Financial Institutions Supervisory Act to investigate any and all aspects of a bank's activities. The bank regulatory authorities have extensive powers to correct abuses; issue cease and desist orders, suspend or remove bank officers and directors, cancel deposit insurance, and revoke charters.

Second, it has long been the public policy of the national government to insure the continued solvency and liquidity of banking institutions and in particular to protect the bank's depositors, in order to maintain the effective use of demand deposits as the principal part of the nation's money supply.

Third, we feel banks would be extremely vulnerable to unmeritorious litigation. Because of their dependence upon public confidence, a bank could not afford the adverse publicity that would be generated by even the most unjustified litigation, and might thus be forced to settle in order to avoid adverse publicity.

The American Bankers Association hopes this Committee would solicit the views of the various financial regulatory agencies on these three bills.

We would like to comment briefly on the particular provisions of these bills that we feel will drastically effect banking.

S. 984 defines "unfair consumer practice" to mean any one of sixteen acts or practices. Section 101 (1) (p) is very broad—"any other act or practice which is unfair or deceptive to a consumer and is prohibited by section 5 (a) (1) of the Federal Trade Commission Act (15 U.S.C. 45 (a) (1)). It is our opinion that this might allow the Federal Trade Commission to obtain jurisdiction over banks. This could then serve as the foundation for class action litigation against the bank.

Section 101 (6) defines "services" to include "insurance services and similar provisions of intangibles, but not the providing of credit to the extent that credit is regulated under the Truth-In-Lending Act. . . ." We believe that this does not provide a meaningful exemption because most phases of "credit" are not regulated under Truth-In-Lending.

S. 1222 follows the principle of S. 984 in its definitions, but does not contain the broad discretion given to the Federal Trade Commission in Section 101 (p) of S. 984. However, Section 2 (f) of S. 1222 defines "services", as "the provision of intangibles, other than (i) insurance services (ii) credit services. . . ."

This language avoids some of the problems we saw in S. 984 in extending jurisdiction of the Federal Trade Commission to banks, because Section 3 (b) brings the "unfair consumer practices" under Section 5 of the Federal Trade Commission Act, from which banks are exempt. However, to insure the fact that the Commission does not attempt to regulate banking we feel that an amendment is needed which we will discuss in another paragraph.

S. 1378 defines an "unfair consumer practice" to mean any of the following:

"(1) any material statement, whether oral, written or by visual description or other representation of any kind, or by half-truth or intentional omission, in connection with the sale, lease, rental, or loan of goods or services to consumers, or the extension of credit to consumers, or the collection of debts from consumers, which has the capacity, tendency or effect of misleading or deceiving consumers. Such statements include, but are not limited to—"

We feel that the term "or the extension of credit" should be deleted, because it attempts to do what the Truth-In-Lending Act already does, that is regulate the disclosure of credit terms.

We would like to suggest a method whereby banks and other financial institutions would be granted an exemption from these class action suits. This would be to redefine "services" in S. 984, S. 1222 and S. 1378 as follows:

S. 984. Section 101 (6) "services includes insurance services and similar provision of intangibles, but does not include services provided by a financial institution insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, or members of the Federal Home Loan Bank System or the administrator of the National Credit Union Administration."

S. 1222. Section 2 (f) "services includes the provision of intangibles other than . . .

(i) insurance services

(ii) services provided by any financial institution insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation or by members of the Federal Home Loan Bank System or the administrator of the National Credit Union Administration."

(iii) . . ."

S. 1378. Section 3 (5) (e) "services includes insurance services, but not the services provided by financial institutions insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation or members of the Federal Home Loan Bank System or the administrator of the National Credit Union Administration."

Because we believe this legislation might subject banks and other financial institutions to class action and to the jurisdiction of the Federal Trade Commission, we oppose this legislation.

We appreciate this opportunity to express our views on these bills.

Sincerely yours,

CLIFFORD C. SOMMER, *President.*

NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS,
Washington, D.C., May 3, 1971.

HON. WARREN G. MAGNUSON,
*Chairman, Senate Committee on Commerce,
Old Senate Office Building, Washington, D.C.*

DEAR MR. CHAIRMAN: The National League of Insured Savings Associations is a nationwide trade association whose members include both Federally-chartered and State-chartered savings and loan associations. This request is submitted on its behalf.

All 50 States and the District of Columbia and the Federal government have supervisory agencies that have jurisdiction over savings and loan association operations. Savings and loan associations therefore are already subject to supervision and regulation with respect to the types of services included in section 101(1) of the Consumer Class Action Act of 1971 (S. 984) and in section 2(a) of the Consumer Fraud Prevention Act of 1971 (S. 1222).

While no savings and loan association would expect to be immune from remedial action if any such service was performed in such a manner as to constitute an unfair consumer practice within either of those bills, it would expect that action to come from the regulatory body to which it is already responsive rather than from some other source.

Financial institutions such as banks, mutual savings banks and credit unions are also subject to supervision and regulation by Federal or State governmental authorities.

Therefore it is respectfully recommended that the proposed definition of services in section 101(6) of S. 984 be revised to read as follows:

"(6) 'services' includes insurance services and similar provisions of intangibles, but not the providing of services offered or extended by regulated banks,

savings and loan associations, mutual savings banks or credit unions and not the adequacy of service of common carriers to the extent regulated; and".

The present reference in section 101(6) to regulation of credit under the Truth in Lending Act appears to be inapposite, because that Act is intended to regulate the disclosure of credit terms rather than to regulate credit itself.

With reference to the proposed definition of "services" in section 2(f) of S. 1222, in order to accomplish a comparable change, it is respectfully recommended that the proposed definition there be revised to read as follows:

"(f) 'services' includes the provision of intangibles, other than—

- (i) insurance services;
- (ii) services offered or extended by regulated banks, savings and loan associations, mutual savings banks or credit unions; and
- (iii) services by common carriers and public utilities, to the extent that unfair consumer practices are prohibited with respect to these services under other Federal law or regulations; and".

It will be appreciated if this letter can be included in the printed record of the hearings on S. 984 and S. 1222.

Sincerely,

WILLIAM F. McKENNA,
General Counsel.

NATIONAL CONSUMER FINANCE ASSOCIATION,
Washington, D.C., May 5, 1971.

Hon. FRANK E. MOSS,
Chairman, Consumer Subcommittee, Senate Committee on Commerce, Old Senate Office Building, Washington, D.C.

DEAR SENATOR MOSS: The National Consumer Finance Association and its members view with misgivings the probable effects on commerce and the judicial system, if the legislation (S. 984, S. 1222 or S. 1378) currently before your subcommittee is enacted into law. We are also convinced that these bills if enacted, could not effectively achieve their stated goals. We believe that further expansion of consumer class action in the federal courts beyond the extensive provisions already included in existing law, will not afford meaningful and effective relief to injured consumers. Moreover, we believe that if it can be shown that a Federal fraud statute is desirable, such a statute should be drafted with utmost care and should apply to all institutions that deal with consumers and not applied selectively.

To support this contention, we have prepared a Position Paper and a Backgrounder on the legislation considered by the Consumer Subcommittee in hearings held April 27 and 29. We respectfully request that this letter and both enclosures be inserted into the official hearing record, which we understand remains open until May 10.

It is our firm belief that consumers are more frequently faced with frustration in their complaints rather than fraud on the part of the businessman. In furtherance of this belief the NCFA has set up a national Consumer Affairs Center to coordinate the handling of consumer inquiries, and if they should arise, resolve any problems or misunderstandings between the consumer and the consumer finance industry. All members of Congress, as well as Federal executive agencies, have been invited to refer any case problems to the Center for action.

The National Consumer Finance Association, organized in 1916, represents approximately 1,000 member companies who operate over 12,000 branch offices of the 23,000 consumer finance offices operating in the United States. All members make loans under cash loan laws of the various states. Some members have insurance and retail subsidiaries, some offer commercial financing, some have manufacturing subsidiaries while others are subsidiaries of highly diversified parent corporations. As an integral part of the nation's social and economic complex, the National Consumer Finance Association and its members are dedicated to the task of providing an adequate source of credit for all who are creditworthy and to the improvement of consumer finance service to the American consumer and his family.

You may be assured that the National Consumer Finance Association and its members stand ready to assist the Consumer Subcommittee in any way which will

accomplish the intent of the Congress and also result in more protection of consumers from fraudulent business practices.

Sincerely,

S. LEES BOOTH, *Vice President.*

Enclosures.

A. RECOMMENDATIONS

It is respectfully recommended by the N. C. F. A. that:

(1) None of the current bills, all of which combine a Federal fraud statute with an expanded class action procedure, be enacted. All bills currently under consideration would make misrepresentation to the consumer on the part of any business a federal offense, regardless of whether or not such misrepresentation were confined to a local area. Moreover, the pending proposals fail to afford meaningful and effective relief against most such abuses, but instead espouse a time-consuming unwieldy, and inefficient "class action" mechanism to confront all wrongs.

(2) The effectiveness of organizations and agencies recently created in response to recognized consumer complaints should be tested, namely, the revitalization and redirection of the Federal Trade Commission, the Consumer Affairs Section in the Department of Justice, Council of Better Business Bureau efforts, The National Institute for Consumer Justice, the Consumer Arbitration Advisory Council, and industry efforts exemplified by the NCFA Consumer Affairs Center. Serious consideration should also be given to fostering the establishment of effective consumer claims courts in an effort to relieve consumer frustrations at the local level.

(3) Despite their limitations, class actions may be a useful procedure in situations involving diversity of citizenship (complainants in different states). If the intent is to expand the use of class actions to include individual claims of any amount, so long as the aggregate is in excess of \$10,000, this could be accomplished by legislation which would remove the requirement that a single claim must exceed \$10,000 as was established in the *Snyder v. Harris* case.

(4) If a Federal fraud statute is deemed necessary, despite the present broad authority of the Federal Trade Commission and the Department of Justice, such a statute should be carefully drafted and should apply to all institutions that deal with consumers.

(5) There are grave dangers in allowing regulatory agencies to determine unilaterally the bases in fact for consumer suits. However, if enlargement of federal jurisdiction is deemed necessary at this time, an official body should be designated which has the authority to establish the basis for consumer class action suits against any institution. There should be a predetermination by a regulatory agency such as the Federal Trade Commission (though the scope of its jurisdiction is questioned) whose function it would be to establish facts on which a class action could be based.

(6) Any federal consumer fraud bill embracing the class action remedy, if adopted, should:

(a) require as a condition to participation in a consumer class action suit as a plaintiff, that a person affirmatively indicate: i) His desire to be included as a member of the class; ii) His agreement to bear his prorata share of court costs and attorney fees should the court award them to the defendant; iii) His agreement to post bond to cover possible costs of (ii) and to pay his prorata share of the cost thereof; iv) His belief that the practice complained of has resulted in damage to him for which relief can be granted, and v) That he has not knowingly contributed to the damage or otherwise practiced fraud on the defendant with respect to the matter in controversy;

(b) permit the court to review the reasonableness of attorneys' fees;

(c) require the court to award court costs and attorneys' fees to the prevailing party;

(d) permit the court to award less than the statutory civil penalties provided for violations of other laws, where it would be inequitable in terms of the violation involved to award even the minimum penalty to each member of the class.

B. CIVIL PENALTIES AS DAMAGES

Many seller/creditors are already being sued for technical violations of the Truth-in-Lending Act. This being a Federal law, the suits are being brought under present Rule 23. Most of the suits take on the aspect of the *Coburn* case; no violations of substance to the contract are alleged, only violations of the disclosure provisions of the act.

The civil penalty for violating any of the disclosure provisions is twice the finance charge, not to be less than \$100 nor more than \$1,000. Although relief is provided for bona fide errors, it is doubtful that this provision would relieve a company from liability where it has intentionally adopted a practice believed to be in compliance but later found to be in violation of the act. Thus, if a nationwide finance company having 2 million accounts errs in designing its disclosure document, it would be subject, at the very minimum, to paying civil penalties totaling 200 million dollars or twice the aggregate finance charges, not to exceed 2 billion dollars!

The problem is caused by the fact that civil penalties are designed to enable a single debtor to go to court with a fair chance of recovering sufficient damages to pay his attorney and receive, in addition, some personal benefit. As a measure of damages in a class action proceeding, however, the theory is clearly inapplicable and may lead to distorted results.

C. COUNTERCLAIMS

It would appear that where a class action is brought against a creditor by numerous debtors all of whom have balances owed to the creditor at the time the suit is instituted, that the creditor would be in the position of having to assert compulsory counterclaims against the debtors even though many of the debtors are not in default in any way on their obligation.

There is scant law on this subject. It appears that the handling of such counterclaims will present a major obstacle to the fair and efficient adjudication of class actions involving a debtor-creditor relationship.

D. DUE PROCESS

The underlying premise in class action suits is that it is a short cut made possible by common questions of law and fact which predominate over any questions affecting only individual members. Such being the case, it is not necessary actually to bring in all parties to the litigation.

This premise comes perilously close to impinging on a very elemental and basic right of the defendant, that is, the right of due process, or put another way, the right to a full and fair hearing. The U.S. Supreme Court has stated:

"A person's right to reasonable notice of a charge against him, and an opportunity to be heard in his defense—a right to his day in court—are basic in our system of jurisprudence; and these rights include, as a minimum, a right to examine the witnesses against him, . . ."

In Re Oliver, 333 U.S. 257 (1948).

Obviously, the right to examine the witnesses against the defendant is curtailed in a class action, it being assumed that one witness (plaintiff) may speak adequately for all. Yet, in any class action based on misrepresentation a fundamental element of proof is the reliance of the individual on the misrepresentation. Such reliance can not, in most cases, be imputed to all plaintiffs but can only clearly be established by direct testimony.

E. REAL PARTY IN INTEREST

As noted by the New York Court of Appeals in *Hall v. Coburn*, privately maintained consumer class actions may become "instruments of harassment benefiting largely persons who activate the litigation." Any federal legislation which is enacted should contain language which gives the court the broadest possible authority to restrict attorneys' fees to the actual time spent by attorneys in preparation and prosecution of the action.

Equally important is the adoption by the federal courts of court rules which place stringent limitations on the freedom of plaintiffs' attorneys to communicate (i.e., solicit fees and expenses) with those who are not actually parties to the action. Every possible safeguard must be invoked to prevent solicitation and communication, except as permitted by the court.

In addition to the foregoing, there should be parity in the award of attorneys' fees and court costs. Either prevailing party should be entitled to costs and attorneys' fees. Moreover, the prospective individual plaintiff should be notified of his liability for attorneys' fees in the event his suit is unsuccessful and should be required to contribute to the payment of a bond to cover the costs and fees, if any, which might be awarded the prevailing defendant.

F. DAMAGES AS FINES OR PENALTIES

As worked out in the antibiotics cases, it was assumed that everyone who did not opt out of the class and did not file a claim, assigned his claim to the State or city of which he was a resident. Thus, money paid by the defendant was used for the benefit of the public rather than compensation of damages allegedly suffered by the consumer plaintiffs. Such a procedure becomes in effect one of levying a fine on the defendant after a private attorney has played a role similar in nature to that of public prosecutor. Such procedure should be unlawful.

G. TIMELY REDRESS OF GRIEVANCES

Court actions can be slow; many federal dockets are years behind. This lack of prompt consideration of a claim is even more pronounced in the case of a class action wherein a lengthy initial determination must be made as to what persons constitute the class. During the pendency of such a determination other remedies, including settlement negotiations, are abated. Swift administrative action or action by the Attorney General's office is a more efficacious remedy for a majority of fraud claims.

H. NEED FOR CONSUMER SATISFACTION

NCFRA recognized that *consumers* who have been defrauded or otherwise injured by abuses of businessmen *should receive reasonable redress for their grievances*. Moreover, if present consumer remedies are not adequate to provide for full and speedy relief, such remedies should either be strengthened, modified or replaced by more satisfactory forms of relief. It is also essential that the remedies be effective against the unscrupulous businessman, but not as tools of harassment against the conscientious businessmen who from time to time are guilty of inadvertent error. Three questions basic to elementary justice should be considered in extending the class action approach: 1) Will the consumer have satisfaction quickly? 2) Who will benefit most—the consumer or the attorney? 3) Do class actions provide due process of law?

A. PENDING LEGISLATION

(1) *What Bills are pending?* At the time of this report, there are five bills pending in the Congress. On the Senate side, they are S. 984 (Magnuson) which is similar to S. 3201 of the 91st Congress, S. 1222 (Magnuson, identical to the proposal of the Justice Department), and S. 1378 (Bayh). In the House, there are two bills—H.R. 5630 (Eckhardt) which is identical to S. 1378, and H.R. 6315 (Staggers and Springer) which is identical to S. 1222.

The hearings which started on April 27 before the Senate Commerce Committee, Subcommittee on the Consumer, concern themselves with S. 984, S. 1222 and S. 1378.

(2) *The Purposes of the Pending Legislation are:* a) Substantively to create forms of "unfair" practices as Federal offenses, and b) Procedurally to extend the class action approach available to consumers for redress of grievances.

(3) *What do they do?* In effect, by broad definition of "unfair consumer practices," most of the State statutory, decisional and common law on consumer fraud is codified into one comprehensive Federal statute.

(4) *How is a Federal Fraud Statute Achieved?* By making it unlawful to commit any one of 14 or 15 "unfair consumer practices" generally relating to any misrepresentation concerning the advertising, need, quality, availability, condition, discounts, sponsorship, origin, characteristics, safety performance, ingredients, as they apply to certain, though not all, goods and services offered the consumer.

(5) *Who is covered?* Services and goods offered by finance companies and retailers would be covered, but there is a question whether the services offered

by nationally chartered or insured banks, savings and loan associations, credit unions and some other institutions would be covered.

(6) *How enforced?* Varied and elaborate provisions are involved for Federal government enforcement through the Federal Trade Commission and Justice Department, and for private suits by individuals and class action.

B. ACHIEVEMENTS IN RESPONSE TO CONSUMER PROBLEMS

(1) *Revitalization of the Federal Trade Commission.* In a major reorganization plan, effective July 1, 1970, the Bureau of Consumer Protection replaced the Bureau of Deceptive Practices, in an attempt to reorient FTC activities and improve its position to meet its statutory responsibilities. A new position, that of Consumer Protection Specialist, was created, and 110 of these specialists were trained and sent to FTC field offices to assist legal staffs in detecting and correcting deceptive business practices and unfair methods of competition. Consumer protection specialists function primarily as investigators, visiting retail stores, finance companies, automobile dealers and other firms extending consumer credit, to insure that their advertising, loan applications and other forms contain clear, complete disclosures of the information consumers need to make wise judgments in shopping for credit.

(2) *Creation of a Consumer Affairs Section in the Department of Justice.* In December 1970, to strengthen enforcement of consumer protection laws, the Consumer Affairs Section in the Antitrust Division was charged with centralizing enforcement of certain consumer protection statutes and giving consumers a focal point for complaints. It is responsible for enforcing the Child Protection and Toy Safety Act of 1969, the Disclosure of Automobile Information Act, the Consumer Credit Protection Act, except as it relates to "loansharking" activities, and other consumer-oriented laws.

(3) *Formation of National Institute for Consumer Justice.* Dedicated to the improvement of the grievance-solving mechanisms and legal remedies of the consumer, the goal of the Institute, in addition to the development of basic information, is an evaluation of existing remedies and of alternative private and public arrangements.

(4) *Council of Better Business Bureaus.* Private enterprise on December 1 launched its program of self-regulation of business practices and consumer assistance. The Council adopted a 14-point program designed "to make our consumers the wisest and toughest in the world and our businessmen the most responsive to their needs." The formation of the Council, effective January 1, 1970, was aimed at revitalizing the Better Business Bureau network to make it "the strong, viable, effective and visible unified consumer assistance agency of national stature that will become the preferred alternative to any governmental or other device."

(5) *Consumer Arbitration Advisory Council.* At a press conference in Washington, D.C. on October 14, 1970, the National Center for Dispute Settlement of American Arbitration Association announced formation of a Consumer Arbitration Advisory Council. Under the plans announced, any individual or consumer can seek arbitration to settle a dispute, even if as little as \$25 is involved. The Council is financed by National Center for Dispute Settlement. The top limit on disputes the Council will handle was set at \$500.

(6) *NCFA Consumer Affairs Center.* On February 1, 1971, the NCFA Consumer Affairs Center was formed to coordinate the handling of consumer inquiries, and if they should arise, resolve any problems or misunderstandings between the consumer and the consumer finance industry. All members of Congress, as well as Federal executive agencies, have been invited to refer any case problems to the Center for action. General inquiries are answered directly from the Center. Questions or problems concerning the relationship of an individual consumer with a specific company within the industry are resolved in cooperation with the officers of that company.

C. BASIC RULES FOLLOWED BY FTC AS A REGULATORY AGENCY

Traditionally in civil fraud actions, the plaintiff must show a false statement on which he relied to his damage. If any of these three elements—falsity, reliance or damage—is absent, the case must fail. However, these protections have largely been ignored in enforcement proceedings under the FTC Act. These rules

that now govern all advertising presumably would be extended to enforcement of a Federal fraud act:

- (1) Tendency to deceive—proof of actual deception is not essential.
- (2) Immateriality of knowledge of falsity—government does not have to prove knowledge of falsity on part of the advertiser.
- (3) Immateriality of intent—wholly innocent intent may still violate law.
- (4) Literal truth sometimes insufficient—advertisement as a whole may be misleading because factors are omitted or message is composed in a misleading way.
- (5) Ambiguous advertisements interpreted to effect purposes of the law—advertisement that can be read to have two meanings is illegal if one of them is false or misleading.

D. PRESENT STATUS OF CLASS ACTION

(1) *Class actions are presently permitted* under Federal law and under the laws of some states. In other states, only equity proceedings under the common law are recognized.

(2) *The truth-in-lending law opened the door* to a broader use of class actions when it permitted actions, not only in U.S. district courts, but also in "any other court of competent jurisdiction." This would seem to allow customers of a national chain to seek out those states where liberal class action laws prevail and bring their lawsuit in one of such states—possibly on behalf of a national class of plaintiffs.

(3) *Federal Courts have been open for many years for class actions*, the requirements being specified by Rule 23 of the Rules of Civil Procedure. Subsection 23 (a) sets out the prerequisites to class action:

"One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class."

Unless all of the above criteria are strictly met and unless the jurisdictional amount exceeds \$10,000 in diversity of citizenship cases (cases involving citizens of more than one state), a federal class action suit may not be maintained. The U.S. Supreme Court in *Snyder v. Harris*, 394 U.S. 332 (1969), decided that the claims of individuals in any class action cannot be aggregated to meet the \$10,000 jurisdictional amount. This severely limits potential consumer class actions under Rule 23.

(4) *The principal class action pending in the Federal Court system* are based on Federal questions, such as securities frauds, or more recently, violations of the Truth-in-Lending Act. Many suits have been brought against major creditors, including Westinghouse Electric Corporation, Sinclair Oil Corporation, Sun Oil Corporation, Mobil Oil Corporation, Atlantic Richfield Company, Cities Service Company, Diners Club, Inc., American Express Corporation, Gimbel Brothers, Inc. and Chemical Bank and New York Trust Company, all of which involve alleged violations of the Truth-in-Lending Act. Other major Federal cases involve General Motors and IBM, the damages in which are alleged to run into many millions of dollars.

(5) *Only a few states have court rules similar to Federal Rule 23*. Nevertheless, there are a substantial number of class actions currently pending under state law. In California, for instance, there are numerous cases, mostly handled by the same law firm, involving credit life insurance commissions and alleged consumer fraud. In Pennsylvania a major credit card company is being sued. Other recently concluded state class actions have tested the time-price doctrine in Tennessee (unsuccessfully) and in Wisconsin (successfully). In New York, a class action (Coburn Finance), based on a technical violation of the Retail Installment Sales Act was rejected by the highest court of that state. Most states, however, do not have class action statutes.

(6) *The fact that a State has no statute or court rule describing a class action does not rule out a class action in that state*. A case in point is *Holstein v. Montgomery Ward & Co., Inc.*, Illinois Circuit Court of Cook County, where the Illinois court held that a class action was appropriate for the estimated 6 million charge account customers of Montgomery Ward, that the law of Illinois applied and further decided that the principles underlying Rules 23 constituted a codification of common law precedence covering class action.

E. REMEDIES FOR CONSUMERS OTHER THAN CLASS ACTION

Most, though not all, consumer complaints are remediable by:

- (1) State administrative action;
- (2) Federal administrative action;
- (3) Individual suits in small claims courts, municipal courts, and lower level courts of general jurisdiction;
- (4) Better Business Bureau complaints.

It should also be recognized that most consumer complaints do not involve fraud on the part of the businessman. Most are due to misunderstanding or inadvertent error.

It has been suggested that if most consumer complaints are not remediable in the above forums, it is because the agencies are not fully performing the functions for which they were designed.

F. ARGUMENTS FOR THE CLASS ACTION APPROACH

It is argued that:

- (1) The availability and threat of class action will serve as a deterrent to unethical business behavior;
- (2) Class actions will provide speedy relief for consumers;
- (3) Lawyers will be induced to represent a broad group of consumers whereas they would not be motivated to represent a single consumer having a small claim;
- (4) Consumer claims would be simplified since many small suits would be combined into one class action;
- (5) When wrongs have been committed against a substantial number of consumers, substantial damage should be awarded and this can be done best through class action suits.

G. ARGUMENTS AGAINST EXPANDING CLASS ACTION BY FEDERAL LEGISLATION

(1) The threat of class actions is having a frustrating effect on the ethical businessman because of the threat of severe penalties for unwillful errors, for example, an error in a business form which is used. However, it is unlikely that such a threat would deter the fringe operator.

(2) The possibility of obtaining speedy relief by the class action route is questionable. Court calendars are so crowded that a speedy trial is frequently impossible to attain. Moreover, there must be a determination by a court as to whether a class action exists. This determination may take as much as three years, and the final settlement several more years.

(3) Some unethical lawyers will be attracted to the potentially large fees from class actions which are possible because companies tend to capitulate rather than suffer the harassment of long drawn out suits which may adversely affect their normal business operations and even the price of their stocks. As stated by the New York Court of Appeals in the *Hall v. Coburn* case, consumer class action suits, without adequate public control, may become "instruments of harassment benefitting largely persons who activate the litigation."

(4) The premise in a typical class action is that there are questions of law or fact common to the members of the class which predominate over questions affecting only individual members. The court must determine on the basis of the testimony of a few whether the questions of law and fact affecting them may fairly be imputed to others who are not before the court. Thus, the defendant has no opportunity to cross examine most of those who are seeking to take his property. The loose application of this premise comes perilously close to violating the most elementary principles of fairness and due process.

H. PROCEDURE IN A FEDERAL CONSUMER CLASS ACTION SUIT

(1) A consumer believing that he had been injured would initially consult an attorney or, the initial step might be taken by an attorney who believed that a violation had taken place. Solicitation of consumers for the purpose of bringing a law suit would, however, raise serious questions of legal ethics.

(2) The attorney consulted would, in all likelihood, initiate a preliminary investigation to determine the extent of the practice and whether other consumers had been injured by it.

(3) The attorney would then begin suit on behalf of the allegedly injured consumer and on behalf of all other consumers similarly situated. After suit has begun, Rule 23 of the Federal Rules of Civil Procedure directs the court to determine, as soon as practicable after its commencement, whether it should be maintained as a class action.

(4) It is quite likely that the parties to a class action would have an opportunity to file written questions directed to each other to develop evidence on these subjects and the opportunity to take the depositions both of each other and also other persons who might have evidence bearing upon these questions.

(5) Once the court concludes that the suit is properly brought as a class action, Rule 23 provides that the court shall direct that the best notice practicable be given to the members of the class, including individual notice to all persons who can be identified through reasonable effort. This notice advises each member of the class that he will be excluded from the class if he so requests by a specified date; that any remaining member may participate directly through an attorney; and that any judgment, whether favorable or not, will bind all remaining members.

(6) After the merits of the action are established trial or settlement would follow. In either event, the court must again give notice to all of the members of the class of any proposed dismissal or compromise of the action, and as to how the members of the class may present individual monetary claims in order to participate in any fund created as a result of settlement or judgment.

RUBBER MANUFACTURERS ASSOCIATION,
Washington, D.C., May 10, 1971.

Hon. FRANK E. MOSS,
Chairman, Consumer Subcommittee, Committee on Commerce, U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of over 180 domestic manufacturers of rubber products, the Rubber Manufacturers Association submits this statement for the Record of the Hearings on consumer class action legislation now pending before your committee.

The concept that consumers are entitled to obtain redress for any damages as a result of fraudulent or deceptive practices is a justifiable one and should form the basis for the development of any consumer protection program.

We submit, however, that to legally sanction the practice of class action would not offer a practical remedy in the overwhelming instances of legitimate consumer complaints. Most complaints are of such a nature that they could not conceivably be considered the basis for class action suits. Surveys of consumer complaints carried out by the Federal Trade Commission, and private associations have adequately reflected the singular nature of consumer grievances. Faulty merchandise, and poor service, are typical of these consumer complaints. In this regard, class action would not be an appropriate or satisfactory remedy.

In order to counter fraudulent practices in the marketplace and in the interest of equity to both the producer and consumer, the Congress would be well advised to consider any number of alternatives which have been offered in lieu of class action.

The strengthening of the Federal Trade Commission to allow involvement in areas which "affect" interstate commerce and to seek injunctions to halt frauds; mandatory private settlement plans; strengthening of small claims courts; federal custodial recovery actions; and pre-trial arbitration devices are all means by which legitimate complaints of the individual consumer would be adequately and swiftly answered.

Actual litigation of a consumer injury should be viewed as a last resort, and not depicted as the primary method for settlement of consumer complaints.

Although pending legislation does recognize the need for voluntary settlement, none of the bills presently allows for pre-trial settlement as judgment in the case. Any individual not agreeing to what the other parties considered to be a fair compromise could continue the suit.

In addition, it seems that the definition of what practices constitute the basis for class action are not clearly defined and thus do not afford the businessman with fair warning to cease a practice, or to forestall potential court claims.

One bill in particular, S. 984 further compounds the problems inherent in the nature of class action suits by setting forth as a basis for such suits violations of Section 5 of the Federal Trade Commission Act. This statute in dealing with advertising and labeling practices which tend to mislead or deceive, would subject industry to a broad gamut of suits based upon acts which may in fact do no financial harm to any consumer.

In those cases where fraud may well constitute the basis for a class action, the very circumstances surrounding the fraud usually means that a suit is impossible. Most consumer fraud is perpetrated by the type of business operation without a geographical location or sound financial base, and in such circumstances a suit would be worthless.

The net effect on the consumer and business community of class action suits cannot be overemphasized. It will not serve as a means for improving and insuring an equitable producer-consumer relationship, but will serve as the vehicle for business harassment, and by which industry will become the target of individuals in search of a bounty. In neither case will a legitimate claim against a fraudulent or deceptive business practice constitute the issue.

The class action proposals now before the Congress pose a serious economic threat to the business community without the intended benefits of further protecting the consumer.

Sincerely,

W. J. SEARS, *Vice President.*

NATIONAL ASSOCIATION OF INDEPENDENT INSURERS,

Chicago, Ill., May 11, 1971.

HON. FRANK E. MOSS,

*Chairman, Subcommittee on Consumer Affairs, Senate Commerce Committee,
U.S. Senate, New Senate Office Building, Washington, D.C.*

DEAR SENATOR MOSS: The National Association of Independent Insurers is a trade association of some 350 fire and casualty insurance companies of all types—stock, mutual, reciprocal and Lloyds insurers. Most of our member companies are engaged in interstate commerce and, hence, have a direct concern over Federal legislation affecting the insurance business.

During the 91st Congressional Session this Association submitted a statement to this Subcommittee in opposition to S-3201 which is similar to the currently pending S-984. For reasons which we will hereinafter express, we wish to reiterate our opposition to S-984 and state that if there is to be a bill enacted into law which will provide consumer class action relief, it is our belief that S-1222 is a preferable alternative. It is our opinion that S-984 would, without any justification whatsoever, bring within the Federal Trade Commission Act certain insurance practices which are and for many years have been fully and adequately regulated by the states; S-1222 does not contain this offensive and unnecessary language.

Section 101(1) of S-984 makes unlawful sixteen enumerated unfair or deceptive acts or practices in the offering for sale or advertising of goods or services. Section 101(6) defines services to include "insurance services and similar provisions of intangibles, but not the providing of credit to the extent that credit is regulated under the Truth-in-Lending Act—or the adequacy or service of common carriers to the extent regulated."

By specifically including insurance in the definition of services this bill would drastically modify the carefully conceived Congressional plan for the regulation of insurance as embodied in the McCarran-Ferguson Act of 1945. That law was enacted by the Congress after a long and searching scrutiny of the insurance business and the state regulatory system. After careful analysis of all possible alternatives, the Congress concluded that the continued regulation of insurance by the states is in the public interest, and that except for conspiracy or acts of boycott coercion or intimidation, the federal antitrust laws should apply to the business of insurance *only to the extent that business is not regulated by State law*. Central to this Congressional plan of insurance regulation, was the determination to avoid wasteful overlapping or duplication of regulation, by entrusting exclusive regulatory power to the states subject only to the exception as to boycott, coercion and intimidation. The other advantages of state supervision—including its close proximity to the insuring public and

the insurance operation, and its experience and expertise in this field—were also well known to the Congress and entered into its carefully weighted decision.

We submit that subparagraph (6) of section (101) of S-984 which would require the inclusion of insurance within the scope of the bill is an unnecessary and superfluous provision, for the following reasons:

(1) The insurance business is now fully subject to strong, effective regulation under the unfair trade practices laws of every state, which laws were adopted specifically to fulfill the Congressional mandate under the McCarran Act.

(2) Those state laws not only contain general prohibitory provisions as broad or broader than those of the Federal Trade Commission Act, but also contain numerous sanctions directly applicable to and appropos of insurance—of which the FTC Act is completely lacking.

(3) The definitions of "unfair or deceptive practices" which S-984 would add to the FTC Act are, like the existing language of that Act, couched in broad, general trade terms which may be meaningful as applied to most businesses but are ambiguous and highly confusing, if not meaningless, when applied to insurance.

(4) Under their trade practice laws and related statutes, the state insurance commissioners have long possessed, and have never hesitated to use where needed, the most powerful of enforcement tools against violations of the unfair trade practice acts—including severe fines and outright suspension or revocation of license to do business.

(5) There have been absolutely no allegations made or testimony presented to indicate that state supervision in this field has not adequately protected the insurance consumer's interests, or to establish any need whatsoever for superimposing federal regulation thereupon.

(6) Extension of the FTC Act to insurance would thrust costly regulatory responsibilities on the federal government which would be unnecessary, duplicative and wasteful; the broad, ambiguous and inapt language of S-984 if applied to insurance would confuse and obfuscate the clear-cut, well-defined insurance regulatory framework now provided by the state trade practice laws, with the net effect of seriously weakening overall regulation in the public interest.

Immediately after the McCarran-Ferguson Act was adopted in 1945, a model "Act Relating to Unfair Methods of Competition and Deceptive Acts and Practices in the Business of Insurance" was developed by the National Association of Insurance Commissioners. As recited in the final draft of the Act, dated January 24, 1947, its purpose is "to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945 (Public Law 15, 79th Congress)."

Subsection 4(a) of the bill defines as unfair methods of competition and unfair and deceptive acts or practices, when engaged in by any person in the insurance business.

- (1) Misrepresentation and false advertising of policy contracts.
- (2) False information and advertising generally.
- (3) Defamation.
- (4) Boycott, coercion and intimidation.
- (5) False financial statements.
- (6) Stock operations and advisory board contracts.
- (7) Unfair discrimination in specified lines of insurance.
- (8) Rebates.

To illustrate the broad sweep of this statute we quote subparagraph 1 and 2 of Subsection 4(a) above noted:

"(1) *Misrepresentation and False Advertising of Policy Contracts.* Making, issuing, circulating, or causing to be made, issued or circulated, any estimate, illustration, circular or statement misrepresenting the terms of any policy issued or to be issued or the benefits or advantages promised thereby or the dividend or shares of the surplus to be received thereon, or making any false or misleading statement as to the dividends or share of surplus previously paid on similar policies, or making any misleading representation or any misrepresentation as to the financial condition of any insurer, or as to the legal reserve system upon which any life insurer operates, or using any name or title of any policy or class of policies misrepresenting the true nature thereof, or making any misrep-

resentation to any policyholder insured in any company for the purpose of inducing or tending to induce such policyholder to lapse, forfeit, or surrender his insurance.

"(2) *False Information and Advertising Generally.* Making, publishing, disseminating, circulating, or placing before the public, or causing, directly or indirectly, to be made, published, disseminated, circulated, or placed before the public, in a newspaper, magazine or other publication, or in the form of a notice, circular, pamphlet, letter or poster, or over any radio station, or in any other way, an advertisement, announcement or statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his insurance business, which is untrue, deceptive or misleading."

Subsection 4(b) of the Model Act declares that its enumeration of specific prohibited methods, acts and practices "is not exclusive or restricted or intended to limit the powers of the Commissioner or any court of review. . . ." Sections 5 to 8 and 11 prescribe enforcement and judicial review procedures and empower the Commissioner to issue cease and desist orders.

Sections 9 and 10 empower the Commissioner after hearing to report to the Attorney General any unfair method of competition or unfair or deceptive act or practice violative of the act but not defined in Section 4(a), and the Attorney General may institute court proceedings to enjoin same.

Section 11 provides for fines of up to \$5000 for each violation of a Commissioner's order—the identical penalty prescribed in the Federal Trade Commissioner Act. Section 12 states that the powers enumerated in this statute shall be additional to all his other powers to punish violations of orders. The effect of this provision is to additionally subject an insurer or agent to revocation of its license to do business.

All of the states have adopted the commissioner's model unfair trade practices law or comparable statute. Attached is a list of citations to the unfair trade practices act of every state.

Not only have the states thereby fully occupied the regulatory area reserved to them by Congress under the McCarran Act, but they have occupied it with legislation designed *expressly and exclusively* for the supervision of insurance practices. The state unfair trade practice acts contain the most comprehensive prohibitions conceivable—and, most important—those prohibitions are couched in terms which have clear-cut, specific meaning and relevancy to the insurance business.

The same cannot be said either of the existing FTC Act or the definitions of "unfair and deceptive practices" which S-984 would add to that Act. Both the FTC Act and S-984 have been designed (and by their very nature must be designed) to stretch across a wide spectrum of business enterprises, and their phraseology must necessarily be very general. Moreover, insurance is diametrically different in most respects from the conventional business enterprises to which the provisions of the FTC Act and S-984 are basically directed. (This very uniqueness of insurance was one of the factors which caused Congress to adopt the McCarran Act in 1945, giving the insurance business a qualified exemption from the antitrust laws if regulated by the states.)

Thus, many of the definitions S-984 would add to the FTC Act either have no discernible meaning in the insurance business, or even worse, may because of their inaptness to that business produce a completely inadvertent, unintended meaning.

In short, extension of the FTC Act to insurance would superimpose on the carefully designed, accurately targeted state regulatory system a set of ill-fitting and inappropriate prohibitions which would only obfuscate and confuse the picture, and ultimately weaken the overall regulatory effort.

Insofar as we can ascertain, no case whatsoever has been made for such a move. A statement made by an assistant Attorney General when discussing the need for this type legislation before the 91st Congress merely recited, without elaboration, that "it is as important to supplement state and federal legislation in the service sector of the economy as in the manufactured goods sector."

This observation may perhaps have validity with respect to service enterprises not now regulated. But it provides no basis for superimposing unnecessary, duplicative and inept federal regulation upon a business which is now being effectively—indeed, stringently—regulated by all the states.

Insofar as the matter of enforcement tools is concerned, it should be noted that the existing state laws not only provide for the imposition of severe fines

on any insurance company, agent or other person violating an order under the unfair trade practices act, but they also empower the insurance commissioner to suspend or revoke the offender's license to do business—the most powerful form of sanction that can be applied against any entrepreneur, and one not present in most walks of business. Insurance Departments have not hesitated to invoke any or all of these enforcement powers where necessary, and their very presence exerts a strong disciplinary influence in the business.

For all the foregoing reasons, the National Association of Independent Insurers strongly urges that insurance services be excluded from any bill such as S-984 which would authorize class actions. If some legislation is to be enacted during the 92nd Congress, we would suggest that it exclude insurance services, as does S-1222.

We will be happy if requested to elaborate upon any of the points raised in this letter.

Respectfully submitted.

ARTHUR C. MERTZ,
National Association of Independent Insurers.

Enclosure.

TABLE B

STATE UNFAIR TRADE PRACTICES ACT

- Alabama*—Secs. 90(1) to Sec. 90(14), tit. 28, Ala. Code (1957).
Alaska—Secs. 21.10.865 to 21.10.880, Alaska Stats. (1962).
Arizona—Art. 6, Secs. 20-441 to 20-458, Arizona Rev. Stats. Ann. (1956).
Arkansas—C. 30, Secs. 66-3001 to 66-3026, as amended, Acts 1959, No. 148, Stat. (1947), 1963 Cum. Pocket Part.
California—Secs. 790 to 790.04, California Ins. Code, 1963 Pocket Part.
Colorado—Secs. 72-15-1 to 72-15-13, Rev. Stat. Ann. (1953).
Connecticut—Secs. 38-60 to 38-64, Gen. Stats. Ann. (Rev. 1958).
Delaware—Secs. 18-531 to 18-538, Del. Ins. Laws (effect 6/13/55).
District of Columbia—No. 1964.
Florida—Secs. 626.0600 to 626.0632, Fla. Ins. Code (1963).
Georgia—Act 748, L. 1950, Secs. 56-701 to 56-714, Ga. Ins. Code Ann. (1960 Rev.).
Hawaii—Secs. 181-641 to 181-646, Hawaii Ins. Laws (1963).
Idaho—Sec. 41-1301 to 41-1327, Idaho Ins. Code (1961).
Illinois—C. 73 Secs. 1028 to 1041, 1963 Cum. Pocket Part.
Indiana—C. 112, L. 1947, Secs. 39-5301 to 39-5318, Stat. (Burns, 1933), 1952 Replacement Vol., as amended, 1955, Ch. 10, § 1, p. 8.
Iowa—Secs. 507B.1 to 507B.14, Iowa Code Ann. (1950), 1963 Cum. Pocket Part.
Kansas—Sec. 40-2401 to 40-2414, Kan. Ins. Laws (1963).
Kentucky—Secs. 304.924 to 304.945, Ky. Ins. Laws (1961).
Louisiana—Act 195, L. 1948, Secs. 22-1211 to 22-1217, tit. 22, Rev. Stat. (1950), as amended, Acts, 1960, No. 402 § 1.
Maine—Secs. 146-158, c. 60, Maine Ins. Laws (1959-60), added c. 317, L. 1961.
Maryland—Secs. 212-234, art. 48A, Md. Ins. Code (1963).
Massachusetts—C. 659, L. 1947, Secs. 1-14, c. 176D, Gen. Laws (1954), as amended.
Michigan—Secs. 2001 to 2088, Michigan Ins. Code (1956) as amended.
Minnesota—Secs. 72 :20-72 :33, Minn. Ins. Laws (1963).
Mississippi—Secs. 5649-01 to 5649-12, Miss. Code Ann. (1956), as amended.
Missouri—Secs. 375.930 to 375.948, 1962 Cum. Suppl.
Montana—Secs. 40-3501 to 40-3522, Mont. Ins. Laws (1961).
Nebraska—C. 170, L. 1947, Secs. 44-1501 to 44-1521, Rev. (1943), as amended.
Nevada—Secs. 666.390 to 686.475, Nev. Ins. Laws (1959 w. 1961 supp.).
New Hampshire—Secs. 417 :1 to 417 :17, N.H. Ins. Laws (1963).
New Jersey—C. 379, L. 1947, Secs. 17 :29B-1 to 17 :29B-14, Rev. Stat. (1937), 1963 Cum. Pocket Part.
New Mexico—Secs. 58-9-9 to 58-9-19, N.M. Ins. Laws (1963).
New York—C. 501, L. 1948, Secs. 270-282, Ins. Law, added c. 501, L. 1948, as amended.
North Carolina—C. 1112, L. 1949, Secs. 58-54.1 to 58-54.13, Gen. Stat. (1950 ed).
North Dakota—Secs. 26-30-01 to 26-30-13, N.D. Ins. Laws (1963).
Ohio—Secs. 3901.19 to 3901.99, Ohio Ins. Laws Ann. (1960), as amended.
Oklahoma—Secs. 36 § 1201 to 36 § 1213, Okla. Stats. Anno.
Oregon—Secs. 736.605 to 736.990, Oregon Rev. Stats.

Pennsylvania—Act 202, L. 1947, Secs. 1151 to 1162, tit. 40, Stat. (Purdon), 1963 Cum. Pocket Part, as amended.
Puerto Rico—Secs. 27.010 to 27.200, R.P. Ins. Code (1957).
Rhode Island—Secs. 27-29-1 to 27-29-11, R.I. Ins. Code (1963).
South Carolina—Act 232, L. 1947, Secs. 37-1201 to 37-1223, Ins. Code (1961).
South Dakota—C. 144, L. 1947, Secs. 31-11A01 to 31-11A08, Code (1959).
Tennessee—Secs. 1201 to 1225, Code (Supp. 1961).
Texas—Art. 21-21, Secs 1 to 12.
Utah—C. 63, L. 1947, Secs. 31-27-1 to 37-27-23, Code (1963).
Vermont—Secs. 4721 to 4738, Vermont Ins. Laws (1963).
Virginia—C. 317, L. 1952, Secs. 38.1-49 to 38.1-57, Code (1950), as amended.
Washington—C. 79, L. 1947, Secs. 48.30.010 to 48.30.250, Rev. Code.
West Virginia—Secs. 3472(8) to 3472(22), W.V. Code (1961).
Wisconsin—C. 520, L. 1947, Secs. 207.01 to 207.13, Wisc. Ins. Laws (1963).
Wyoming—Secs. 26-165.5, Wyo. Ins. Laws (1961).

NATIONAL ASSOCIATION OF HOME BUILDERS,
 Washington, D.C., May 19, 1971.

Hon. WARREN G. MAGNUSON,
 Chairman, Committee on Commerce,
 U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: We understand that the Committee now has under consideration S. 984 introduced by you and other members of the Senate as the "Consumer Class Action Act of 1971." We would like this letter to be considered as the statement of the National Association of Home Builders with respect to S. 984 and similar legislation and would appreciate our views being considered by the Committee in conjunction with any action it may take on the bill. As requested by the Committee staff, we are enclosing four extra copies.

S. 984 would authorize suits, including class action suits, by consumers who have been injured by an unfair consumer practice. Unfair consumer practice is defined in the bill to include a broad range of deceptive and misleading activities on the part of those selling goods and services to the public. Both goods and services are defined so as to be broadly inclusive, with goods specifically including real property.

It is this inclusion of real property in the definition of goods that concerns us. Real property would be bracketed in with personal property, and remedies designed primarily to deal with problems arising from the sale of personal property would be applied to commercial transactions concerning real property. The sale of personal property or merchandise (what is normally thought of as goods) is inherently different from the sale of real property and the law has historically prescribed different remedies and types of action with respect to the two.

As we understand it, one of the principal reasons for authorizing a class action approach to rectifying the types of practices covered by this bill is the small amount involved in most consumer transactions when measured against the most consumer transactions when measured against the cost of instituting and prosecuting a civil suit. This has generally deterred those wronged from pursuing on an individual basis their available remedies through court action. Such is not normally so with respect to commercial sales of real property, since the amount involved in an individual transaction, especially when the land has improvements on it, is quite substantial in comparison to the cost of most items of personal property purchased by consumers. This substantial value, therefore, probably has led to a significantly higher proportion of suits with respect to instances where the purchaser of real property has considered himself misled or defrauded than has likely been true in the case of similarly situated purchasers of personal property.

Additionally, because of its unique nature, real property and the sellers of real property have been regulated to a considerably higher degree under state and Federal law than has been true for personal property. The bill recognizes that such regulation deserves exemption of regulated categories from its coverage since among others the sale of securities and the providing of credit to the extent that credit is regulated under the Truth-in-Lending Act are exempted from the bill's coverage.

Real estate, when commercially sold, in practically all states may be sold only by those licensed and regulated by the state. Additionally, those building

homes for sale, the largest percentage of whom are our members, also are strictly regulated as to the types of materials and practices that must be followed with respect to the construction of such homes by state and local building, electrical, and other codes. Furthermore, close to 50% of the homes built in this country each year are inspected during construction, for compliance with detailed Government standards, by inspectors employed by either the Federal Housing Administration or the Veterans' Administration. These homes are required to meet minimum standards which in many cases are even more stringent than those prescribed by state or local law.

The only sale of real property in which the amount even approaches the amount involved in most sales of personal property is that involving the sale of undeveloped lots on a large scale basis in recreation, retirement and similar communities. In some cases such lots may sell for less than \$1,000 apiece. However, this industry is closely regulated by the Federal Government through the Department of Housing and Urban Development which administers the Interstate Land Sales Full Disclosure Act. This Act, passed by the Congress in 1968, is closely patterned after the Securities Act administered by the Securities and Exchange Commission, and it provides its own remedies for anyone defrauded by a seller of such undeveloped land.

We, therefore, believe strongly that a commercial real property sales transaction is significantly different from a commercial transaction involving the sale of merchandise or personal property. We also believe that real property transactions are at present adequately regulated at both the state and Federal level and that real property sales should be removed from the bill's coverage.

This position is in accordance with a resolution adopted by our 800-member Board of Directors at its meeting on September 21, 1970 in Boston, Massachusetts. At that time there were pending in the 91st Congress several bills similar to S. 984 and that resolution was directed at those bills. In the resolution we called attention to the protections afforded the consumer by existing Federal and state legislation and urged the elimination of real property transactions from the coverage of pending class action legislation. A copy of this resolution is enclosed.

We appreciate this opportunity to file this statement with the Committee on S. 984. If there are further questions on this one point with which we are concerned, we will be glad to answer them.

Sincerely,

JOHN A. STASTNY, *President.*

Enclosures.

NAHB RESOLUTION—SEPTEMBER 21, 1970, BOSTON, MASSACHUSETTS

NATIONAL LEGISLATIVE COMMITTEE, CONSUMER PROTECTION LEGISLATION

Whereas, there are now pending in the Congress a number of bills designed to protect consumers from fraud and misrepresentation by sellers of goods, and

Whereas, some of these bills involving class actions would encompass real property transactions along with other commercial transactions, and

Whereas, securities and interest in securities would be excluded from class actions under pending legislation because they are amply protected by existing federal and state legislation, and

Whereas, real property transactions enjoy the same protection for the consumer by existing federal and state legislation: Now, therefore, be it

Resolved, that NAHB urge Congress to eliminate real property transactions from the coverage of class action legislation now pending in the Congress.

NATIONAL ASSOCIATION OF INSURANCE AGENTS, INC.,
Washington, D.C., May 28, 1971.

HON. FRANK E. MOSS,
*Chairman, Subcommittee on Consumer Affairs, Senate Commerce Committee,
U.S. Senate, New Senate Office Building, Washington, D.C.*

DEAR SENATOR MOSS: On behalf of the members of the National Association of Insurance Agents, representing some 33,500 independent agencies with approximately 150,000 individually licensed insurance producers located through-

out the nation, I am writing to you to express our deep interest in and concern for the public interest, as well as our own, in connection with consumer class action legislation.

This Association respectfully observes that S-984 will bring certain insurance matters, which for many years have been fully and completely regulated by the states, under the Federal Trade Commission. Section 101(1) of S-984 enumerates several unfair or deceptive acts or practices in the offering for sale or the advertising of goods or services. Section 101(6) is specifically directed toward "insurance services and similar provisions of intangibles . . ." Violations of the listed unfair consumer practices would trigger proceedings by the Federal Trade Commission.

The inclusion of insurance in this definition of service creates, we believe, an unnecessary conflict with the state regulatory pattern developed as a result of the McCarran-Ferguson Act of 1945. That legislation states that, except for acts of boycott, coercion or intimidation, the federal antitrust laws would apply to the business of insurance only to the extent that business is not regulated by state law. Should S-984 be made into law as presently written, it would unquestionably create a regulatory overlap with state regulation of the insurance business.

We respectfully submit that the states have passed an unfair trade practices act and these statutes are an adequate answer to any claim of unfair or deceptive practices insofar as insurance services are concerned. The state statutes have been effective, have worked well and were created to conform to the supervisory scheme of McCarran-Ferguson.

We note that S-1222, a similar bill, does not include insurance as one of its services and we suggest that this statute is much to be preferred.

In conclusion, it is our belief that the insurance matters treated within S-984 can be adequately handled in the interest of the consumer without including insurance under Section 101(6), which appears to us only to duplicate the regulatory pattern under which we presently function.

We very much appreciate the opportunity to express our views to the Committee on this important matter.

Very truly yours,

HOWARD H. LEIGHTON, *President.*

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE,

June 21, 1971.

HON. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: This letter is in response to your request of March 8, 1971, for a report on S. 984, a bill "To authorize classes of persons injured by unfair consumer practices unlawful under the Federal Trade Commission Act to seek relief."

Briefly stated, this bill would provide that consumers who have been victimized by unfair consumer practices could initiate class action suits in matters which now involve sums too small to justify individual litigation. The bill does, however, provide that every member of a consumer class action must have been involved in a transaction exceeding ten dollars.

On February 24 the President delivered his Consumer Message recommending specific legislation. Among his proposals was S. 1222, the Consumer Fraud Prevention Act of 1971. This bill would provide that consumers may initiate class actions in Federal court against businessmen who are guilty of any one of fourteen specific forms of "hard core" deception. This right would, however, be contingent on the successful termination of a government suit under the Consumer Fraud Prevention Act. In contrast, S. 984 would not condition the consumer's right to initiate class actions upon a prior successful action by the government.

There is no doubt that the threat of appropriate class action suits would be helpful in creating a marketplace where the consumer could make an intelligent and safe choice among similar products. For that reason we would support the enactment of legislation providing consumers with authority to initiate class

actions. However, for the reasons stated by the Department of Justice and the Office of Consumer Affairs in testimony before your Committee on April 27, 1971, we would prefer enactment of S. 1222 rather than S. 984.

We are advised by the Office of Management and Budget that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

(s) JOHN G. VENEMAN,
Acting Secretary.

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE,
June 21, 1971.

Hon. WARREN G. MAGNUSON,
Chairman, Committee on Commerce,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: This letter is in response to your request of April 14, 1971, for a report on S. 1378, a bill "To provide implementation of the Federal Trade Commission Act, to give increased protection to consumers, and for other purposes."

Briefly stated, this bill would provide that consumers who have been victimized by unfair consumer practices could initiate class action suits in Federal and State courts on matters which now involve sums too small to justify individual litigation. In order to bring such an action, however, the bill would require that the aggregate amount of the claims reasonably expected to be in controversy must exceed \$25,000 and that each individual claim must exceed ten dollars.

On February 24, 1971, the President delivered his Consumer Message recommending specific legislation. Among his proposals was S. 1222, which may be cited as the Consumer Fraud Prevention Act. This bill would provide that consumers may initiate class actions in Federal court against businessmen who are guilty of any one of fourteen specific forms of "hard core" deception. This right would, however, be contingent on the successful termination of a government suit under the Consumer Fraud Prevention Act. In contrast, S. 1378 would not condition the consumer's right to initiate class actions upon a prior successful action by the government.

There is no doubt that the threat of appropriate class action suits would be helpful in creating a marketplace where the consumer could make a more intelligent choice among similar products. We would, therefore, support the need for enactment of legislation providing consumers with authority to initiate class actions. However, for the reasons stated by the Department of Justice and the Office of Consumer Affairs in testimony before your Committee on April 27, 1971, we would prefer enactment of S. 1222 rather than S. 1378.

We are advised by the Office of Management and Budget that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

(s) JOHN G. VENEMAN,
Acting Secretary.

MAY 12, 1971.

Hon. FRANK E. MOSS,
Chairman, Subcommittee on Consumers,
Committee on Commerce,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I am writing to you in connection with S. 984, S. 1222, and S. 1378, bills which would give increased protection to consumers, and which are now before your Subcommittee for consideration.

Following his review of each of these bills, our General Counsel advises that, while each bill is quite broad in scope, he does not believe that any of them is intended to be applicable to the operations of the Federal National Mortgage Association. However, he does note that, because of the rather broad definition in the bills of the term "services", there is always the possibility of a contrary interpretation.

Accordingly, we respectfully request that FNMA be specifically exempted from any one or all of these bills when they are reported from your Subcommittee.

FNMA, as you know, is a privately owned corporation chartered under an Act of Congress. It serves primarily as a mortgage market facility, supplementing the secondary market for residential mortgages. FNMA purchases, sells, and otherwise deals in mortgages of residential properties, which may be either Federally insured or guaranteed or conventional.

One reason for seeking a specific exemption from each of these bills lies in the fact that FNMA, although a private corporation, is Federally chartered and is subject to explicit Federal supervision and regulation. The appointment by the President of the United States of five of FNMA's 15-man Board of Directors and the regulatory powers of Federal officers (the Secretary of HUD and the Secretary of the Treasury) as provided for in the FNMA Charter Act (12 U.S.C.A. 1716, et seq.) should prove a more effective way of insuring that FNMA continues to operate in the public interest.

Stated otherwise, the unfair consumer practices which each of these bills seeks to prevent are not engaged in by institutions which are regulated and supervised by Federal agencies, and we do not believe that it would be in the public interest to subject FNMA to such class action suits as would be authorized by these proposals.

Accordingly, we strongly urge that in each of the three bills the definition of the term "services" be amended. Specifically, in S. 984, we suggest that page 5, line 13, be amended to read "similar provisions of intangibles, but not the services of national mortgage associations, nor the providing". In S. 1222, we suggest that on page 5, line 22, strike the word "and", and between lines 22 and 23, insert the following: "(iii) services of national mortgage associations; and". In S. 1378, we suggest that Section 3(e) be amended to read: "'Services' includes insurance services, but excludes services of national mortgage associations."

I am asking our General Counsel and our Director of Legislative Affairs to make themselves available to you and your staff should you so desire.

Sincerely,

OAKLEY HUNTER.

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